

Higher Education Loan Authority of the State of Missouri

Financial Statements as of and for the
Years Ended June 30, 2010 and 2009,
Supplementary Schedule of Expenditures of Federal
Awards for the Year Ended June 30, 2010, and
Independent Auditors' Reports

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of the
Higher Education Loan Authority
of the State of Missouri
Chesterfield, Missouri

We have audited the accompanying statements of net assets of the Higher Education Loan Authority of the State of Missouri (the "Authority") as of June 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These basic financial statements are the responsibility of the management of the Authority. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Higher Education Loan Authority of the State of Missouri, as of June 30, 2010 and 2009, and its changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 1, 2010, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3–14 and the Schedule of Funding Progress on page 44 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Higher Education Loan Authority of the State of Missouri's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the

methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the Higher Education Loan Authority of the State of Missouri's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. This supplementary information is the responsibility of the Higher Education Loan Authority of the State of Missouri's management. The schedule of expenditures of federal awards has been subjected to the auditing procedures applied by us in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects in relation to the basic financial statements taken as a whole.

A handwritten signature in black ink that reads "Deloitte + Touche LLP". The signature is written in a cursive, flowing style.

October 1, 2010

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

MANAGEMENT'S DISCUSSION AND ANALYSIS AS OF AND FOR THE YEARS ENDED JUNE 30, 2010 AND 2009 (Unaudited)

The Management Discussion and Analysis of the financial performance of the Higher Education Loan Authority of the State of Missouri (the "Authority") is required supplementary information. This discussion and analysis provides an analytical overview of the Authority's condensed financial statements and should be read in conjunction with the financial statements that follow.

THE AUTHORITY

The Authority is recognized as one of the largest nonprofit student loan secondary markets in America by statistics gathered and maintained by the U.S. Department of Education. The Authority is a leading holder and servicer of student loans with over \$4.6 billion in assets.

The Authority was created by the General Assembly of the State of Missouri through passage of House Bill ("HB") 326, signed into law on June 15, 1981, in order to insure that all eligible post-secondary education students have access to guaranteed student loans. The legislation was amended, effective August 28, 1994, effective August 28, 2003, and again effective May 2, 2008 to provide the Authority with generally expanded powers to finance, originate, acquire, and service student loans, including, but not limited to, those guaranteed or insured pursuant to the Higher Education Act.

The passage of HB 221, effective August 28, 2003, allows the Authority to originate Parent Loans for Undergraduate Students ("PLUS" loans) and extends the date for repayment of bonds issued by the Authority from 30 to 40 years. The bill also repealed sections of law setting restrictions on variable-rate unsecured loans. The repeal of variable rate restrictions allows the Authority to restructure the rates assessed for the Supplemental and Qualified Institution Loan Programs.

The passage of Senate Bill ("SB") 389, effective August 28, 2007, further amended the Authority's purpose in order to support the efforts of public colleges and universities to create and fund capital projects, and in order to support the Missouri Technology corporation's ability to work with colleges and universities in identifying opportunities for commercializing technologies, transferring technologies, and to develop, recruit, and retain entities engaged in innovative technologies. In addition, powers of the Authority were amended to include fund transfers to the Lewis and Clark Discovery Fund (discussed in the footnotes to the financial statements) and authorized the Authority to participate in any type of financial aid program that provides grants and scholarships to students.

The enactment of SB 967 on May 2, 2008, allows the Authority to originate Stafford loans, however "the Authority's origination of Stafford loans under the Federal Family Education Loan Program ("FFELP") shall not exceed ten percent of the previous year's total Missouri FFELP volume as determined by the Student Market Measure report, data from the U.S. Department of Education or other reputable sources." The Authority originated and disbursed just under \$155 million of Stafford loans during fiscal 2010 compared to \$76 million for fiscal 2009.

Due to the enactment on March 30, 2010, of the Health Care and Education Reconciliation Act of 2010 ("HCEARA") which included the Student Aid and Fiscal Responsibility Act ("SAFRA") and eliminated the FFELP effective July 1, 2010 including the origination of new FFELP loans after June 30, 2010, the

Authority will not be originating FFELP loans in the future. As of July 1, 2010, all loans made under the Higher Education Act will be originated under the Federal Direct Student Loan Program (Direct Loan Program). However, the Authority is already pursuing a contract with the U. S. Department of Education (“the Department”) to service Direct Loan Program loans in accordance with HCERA, Public Law 111-152, which requires the Secretary to contract with each eligible and qualified not-for-profit servicers to service loans. The Department has already determined that the Authority meets the basic eligibility requirements for a not-for-profit servicer as outlined in HCERA with final determinations of eligibility and qualifications under the terms of the statute to be made as part of a future formal solicitation process. In addition to pursuing a federal loan servicing contract the Authority also still services over \$4.2 billion of its own student loans and \$1.4 billion in lender partner owned loans that will provide the Authority ongoing revenue streams for many years to come. This legacy portfolio and its related revenue will assist the Authority in a gradual and smooth transition to a direct loan servicing business model.

The Authority is governed by a seven-member Board, five of whom are appointed by the Governor of the State, subject to the advice and consent of the State Senate, and two others who are designated by statute, the State Commissioner of Higher Education, and a member of the State Coordinating Board for Higher Education. Raymond H. Bayer, Jr., appointed by the Board during fiscal 2007, serves as Executive Director and Chief Executive Officer of the Authority.

The Authority owns and services student loans established by the Higher Education Act under FFELP. Loans authorized under FFELP include: (a) loans to students meeting certain financial needs tests with respect to which the federal government makes interest payments available to reduce student interest cost during periods of enrollment (“Subsidized Stafford Loans”); (b) loans to students made without regard to financial need with respect to which the federal government does not make such interest payments (“Unsubsidized Stafford Loans” and, collectively with Subsidized Stafford Loans, “Stafford Loans”); (c) loans to parents of dependent undergraduate and graduate students, or to graduate or professional students (“PLUS Loans”); and (d) loans available to borrowers with certain existing federal educational loans to consolidate repayment of such loans (“Consolidation Loans”). The Authority also owns consolidated Health Education Assistance Loans (“HEAL”) established by the Public Health Service Act and insured through the Department of Health and Human Services (“HHS”). In addition, the Authority is the lender and servicer for supplemental loans, which are also known as private or alternative loans. These supplemental loans were previously made available predominantly to students in the Midwest who reached the maximum available funding under FFELP. There are several types of loans under the supplemental program including those for borrowers attending eligible undergraduate, technical, graduate, law, medical, and pharmacy schools. Supplemental loans are not guaranteed by the federal government.

The Authority suspended its federal consolidation and supplemental loan programs during fiscal 2008 due in part to credit market disruptions, which make financing these loans more difficult. The Authority’s federal consolidation loan program was suspended due to increased origination fees payable to the federal government and reductions to the lender yield required by federal law. As it relates to the supplemental loan program, in addition to increasing delinquencies and defaults in the Authority’s existing portfolio, the creation of the Federal Grad PLUS program increases the risk profile of future supplemental loans, which are now made predominantly to undergraduate students as opposed to graduate and professional students.

The Authority purchased/originated \$939 million of gross principal student loans from a variety of financial institutions during fiscal 2010. This compares to \$842 million of gross principal during fiscal year 2009 and \$1.3 billion of gross principal during fiscal year 2008 representing a 10% increase for fiscal 2010 compared to a 35% decrease for fiscal 2009. For fiscal 2010, the Authority originated \$180 million Stafford and PLUS loans and purchased \$718 million in loans from lender partners. The remaining \$41 million consisted of \$30 million rehabilitated loans purchased from the Missouri guaranty agency and \$11 million in repurchases from various guarantors of loans that had previously been in a bankruptcy status. The Authority did not

originate or purchase any supplemental or consolidation loans during fiscal 2010. While student loan purchases increased, the Authority also collected servicing fee income from its lender partners for serviced loans that in the past would have been purchased. In fiscal 2010, the Authority's income was supplemented by over \$7.1 million in servicing fee income. In addition, the Authority received approximately \$19.6 million in revenues associated with the sale of loans to the Department through the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA) Federal Loan Participation Purchase Program.

The net loan activity of new purchases less existing loan principal decreases through borrower and claim payments, cancellation activity, and loan sales, resulted in a decrease of 4% from \$4.4 billion to \$4.2 billion in the student loan portfolio from fiscal 2009 to fiscal 2010 as compared to a 15% decrease from \$5.2 billion to \$4.4 billion from fiscal 2008 to fiscal 2009. As of the end of this fiscal year the student loan portfolio held by the Authority is made up of approximately 34.6% Consolidation Loans, 51.5% Stafford Loans, 8.5% PLUS Loans, 5.4% Supplemental Loans, and less than 0.1% HEAL Loans. This compares to 35.4% Consolidation Loans, 49.6% Stafford Loans, 9.6% PLUS Loans, 5.4% Supplemental Loans, and 0.1% HEAL Loans as of year-end fiscal 2009.

While difficult credit markets required the Authority to primarily rely on the federal programs created under the ECASLA Federal Loan Participation Purchase Program to finance all new student loan originations and most of its student loan acquisitions during fiscal 2009, the Authority completed three successful bond financings in fiscal 2010 utilizing the LIBOR floating rate note market. In the first transaction, which closed on November 5, 2009, the Authority issued and privately placed \$186.0 million in LIBOR floating rate notes ("LFRNs") in the 2009-1 Trust to refinance the non Straight-A Conduit eligible assets from the 2005 Trust, which were primarily consolidation loans. In the second transaction, which closed on January 28, 2010, the Authority issued \$761.4 million in LFRN bonds under the 2010-1 Trust to purchase and extinguish \$819.2 million of failed auction rate bonds from the Eleventh General Student Loan Bond Resolution ("11th General") at a discount. In the third transaction, which closed on May 26, 2010, the Authority issued \$822.5 million in LFRN bonds under the 2010-2 Trust to redeem \$49.8 million in fixed rate bonds from the 6th General at a 0.5% premium, to redeem the \$33.9 million in variable rate demand notes from the 8th General at par, and to purchase and extinguish \$704.0 million in failed auction rate bonds from the 11th General at a discount. The \$822.5 million in bond proceeds were also utilized to purchase loans from MOHELA's operating fund.

During fiscal 2010, the Authority placed over \$468 million in loans in the ECASLA Federal Loan Participation Purchase Program and had put over \$704 million in loans through the ECASLA Federal Loan Purchase Commitment Program. The Authority plans to continue to utilize both the Participation and Purchase programs through September 17, 2010 and October 15, 2010, respectively. The programs will no longer be available to the Authority after those dates because both programs are expiring. The Authority will continue to utilize the ECASLA Straight-A Conduit during fiscal 2011 as that program is available through November 19, 2013. On October 30, 2009, the Authority funded an additional \$118.6 million in loans through the Straight-A Conduit to refinance eligible assets held under the 2005 Trust. As of June 30, 2010, the Authority had \$282.1 million in loans outstanding under the Straight-A Conduit.

On June 24, 2009, the Authority entered into a new \$80 million revolving line of credit with three banks to serve as a "bridge" financing for the Authority's utilization of the ECASLA Federal Loan Participation Purchase Program. The ECASLA Program requires that a student loan be originated and disbursed before it can be financed in the program, so the Authority temporarily (usually for less than a week) borrows funds from this facility to initially disburse new student loans before the loan is participated into ECASLA. The bridge financing was terminated on May 24, 2010 because it was no longer needed given the small remaining ECASLA Participation Program eligible volume and the pending closure of the ECASLA Participation and Purchase Programs. Additional information regarding the ECASLA Programs can be found in the continuing developments section.

The 2005 Trust Bonds referred to above, were credit enhanced by a synthetic letter of credit, which consisted of a standby bond purchase agreement (liquidity provider) and a bond insurance policy. The bond insurer's credit rating was downgraded and most of the bonds were put to the liquidity provider. The put bonds are known as bank bonds, which under the bond documents carry an interest rate indexed to prime. Indexing the bonds to prime led to higher interest rates on the bonds, which were in excess of the yield on the assets resulting in net losses in the trust. As noted above, the Authority was able to work with the transaction parties in the trust to refinance the bonds into the Straight-A Conduit on October 30, 2009 and into the 2009-1 Trust on November 5, 2009.

The Authority continues to focus on the development of creative solutions to support the Authority's mission. In the past, the Authority has offered various rate reduction programs to borrowers who establish payments through automatic deduction as well as various loan forgiveness programs. Beginning in fiscal 2009, the Authority modified its borrower benefits to comply with new requirements related to the Federal ECASLA programs. As a result, borrowers who establish payments through automatic deduction can receive a 0.25% interest rate reduction. In Fiscal 2010, the Authority utilized a new program called the Director's choice program that provides three one thousand dollar hardship grants to needy students for each of the 154 Missouri post-secondary institutions. During Fiscal 2010, the Authority provided \$0.4 million in Director's choice grants. In Fiscal 2011, the Authority will provide \$30 million in funds for the State of Missouri's need based scholarship program, Access Missouri. The Authority has set aside \$30 million in cash in a separate account for this purpose. The first payment of \$9 million was made to the State of Missouri on September 1, 2010, with subsequent payments of varying amounts planned on the first of the month for the next 7 months. The Authority reserves the right to modify these programs as needed. The Authority has granted over \$47.3 million in loan forgiveness for a variety of student borrowers including teachers, Pell Grant recipients, and those in military service. Borrowers received over \$9.4 million in loan forgiveness during fiscal 2010, in addition to \$2.1 million during fiscal 2009 and \$1.5 million during fiscal 2008.

FINANCIAL POSITION

This report includes three financial statements: the statements of net assets; the statements of revenues, expenses, and changes in net assets; and the statements of cash flows. These financial statements are prepared in accordance with Government Accounting Standards Board principles. The statements of net assets present the financial position of the Authority at the end of the fiscal year and include all assets and liabilities of the Authority. The statements of revenues, expenses, and changes in net assets present the Authority's results of operations. The statements of cash flows provide a view of the sources and uses of the Authority's cash resources.

Condensed financial information and a brief synopsis of the variances follow:

CONDENSED STATEMENTS OF NET ASSETS
(In thousands)

	2010	2009	2008
Cash and cash equivalents	\$ 242,721	\$ 145,363	\$ 124,024
Accrued interest receivable	112,844	136,868	163,331
Capital assets	14,045	14,182	14,202
Other	25,435	24,991	31,980
Student loans receivable	<u>4,229,752</u>	<u>4,415,659</u>	<u>5,169,858</u>
Total assets	<u>\$ 4,624,797</u>	<u>\$ 4,737,063</u>	<u>\$ 5,503,395</u>
Current liabilities	\$ 950,145	\$ 783,136	\$ 513,415
Long-term liabilities	<u>3,359,542</u>	<u>3,785,520</u>	<u>4,877,912</u>
Total liabilities	<u>\$ 4,309,687</u>	<u>\$ 4,568,656</u>	<u>\$ 5,391,327</u>
Invested in capital assets	\$ 14,045	\$ 14,182	\$ 14,202
Restricted	217,214	126,276	51,172
Unrestricted	<u>83,851</u>	<u>27,949</u>	<u>46,694</u>
Total net assets	<u>\$ 315,110</u>	<u>\$ 168,407</u>	<u>\$ 112,068</u>

**CONDENSED STATEMENTS OF REVENUES,
EXPENSES AND CHANGES IN NET ASSETS**
(In thousands)

Interest on loans	\$ 187,621	\$ 237,404	\$ 280,835
Special allowances	(89,617)	(47,953)	22,085
ECASLA income	19,578	-	-
Gain on extinguishment of debt	139,461	-	-
Investment income and other	<u>7,440</u>	<u>4,665</u>	<u>6,241</u>
Total operating revenues	<u>264,483</u>	<u>194,116</u>	<u>309,161</u>
Bond expenses	58,510	131,021	235,802
Student loan expenses	25,139	26,752	32,632
Administrative and general expenses	<u>34,131</u>	<u>31,358</u>	<u>34,812</u>
Total operating expenses	<u>117,780</u>	<u>189,131</u>	<u>303,246</u>
Operating income before special items	146,703	4,985	5,915
Special items	<u>-</u>	<u>51,354</u>	<u>(233,870)</u>
Change in net assets	<u>\$ 146,703</u>	<u>\$ 56,339</u>	<u>\$ (227,955)</u>

FINANCIAL ANALYSIS

Financial Position

Total assets decreased \$112 million compared to a decrease in liabilities of \$259 million resulting in an increase to the Authority's net assets of \$147 million in fiscal 2010. This increase compares favorably to an increase of \$56 million in fiscal 2009. The change in net assets in fiscal 2010 is primarily tied to net gains on the extinguishment of debt of \$139.5 million, which included two large purchases and extinguishments of

\$819.2 million and \$704.0 million in bonds at a discount, the refinancing of the 2005 Trust Indenture and several smaller purchases and extinguishments of bonds at a discount. In fiscal 2009, the primary factor in the increase in net assets was tied to gains on the repurchase of debt of \$50 million.

Cash and cash equivalents increased by 67% to \$242.7 million in fiscal 2010 from \$145.4 million in fiscal 2009, as compared to an 17% increase from \$124.0 million in fiscal 2008 to fiscal 2009. The current and prior year increases in cash are due to the loss of recycling in all but one trust estate, which prevents cash from being reinvested in student loans. As required by the bond resolutions, this cash must predominantly be utilized for the purchase and extinguishment of debt or the optional redemption of debt.

Accrued interest receivable is down 18% from fiscal 2009 as compared to a 16% decrease from fiscal 2008 to fiscal 2009 and is a direct result of the decrease in interest rates on student loans from fiscal 2009 to 2010.

Other assets, which include deferred charges, pension asset, as well as, miscellaneous receivables and prepaid expenses increased from \$25.0 million in fiscal 2009 to \$25.4 million in fiscal 2010. The change is the result of a \$2.5 million increase in the short and long-term deferred charges from \$14.7 million in fiscal 2009 to over \$17.2 million in fiscal 2010. The increase in short and long-term deferred charges is due to the unamortized costs of issuance associated with the Authority's three new bond transactions. This increase was partially offset by a \$2.3 million reduction in miscellaneous receivables and prepaids as well as a \$0.2 million reduction in the pension asset.

Student loans receivables decreased 4% from \$4.4 billion in fiscal 2009 to \$4.2 billion in fiscal 2010 as compared to a 15% decrease from \$5.2 billion in fiscal 2008 to fiscal 2009. The fiscal 2010 decline is primarily related to the Authority's sale of over \$704 million in loans through the ECASLA purchase program and the net of the purchase activity less loan principal reductions during fiscal 2010 and fiscal 2009. The fiscal 2009 decline was primarily related to the Authority's sale of over \$1.1 billion in loans. The fiscal 2009 sale of loans was prompted by a mutual desire of the Authority and certain investors to redeem auction rate bonds.

For fiscal 2010, current liabilities increased by \$167.0 million due to increases in current bonds payable of \$36.3 million, ECASLA participation payable of \$183.2 million and Conduit payable of \$102.1 million, which was partially offset by a \$142.4 million decline in other liabilities. Long-term liabilities decreased by \$426.0 million or 11% as the Authority redeemed significant amounts of long-term debt at a discount. The overall decrease in total liabilities is the result of the aforementioned bond redemptions. Despite the overall decrease in liabilities, the Authority did complete three new bond issuances of \$186.0 million, \$761.4 million and \$822.5 million and utilized the federal ECASLA participation program and Straight-A Conduit to finance student loans. However, the \$1.8 billion in bond issuances were offset by \$2.2 billion in bond extinguishments and redemptions in fiscal 2010. The Authority also closed its \$80 million revolving line of credit with three banks that served as a "bridge" financing for the Authority's utilization of the ECASLA Federal Loan Participation Program.

Operating Results

Change in net assets increased 160% to \$146.7 million in fiscal 2010 from \$56.3 million in fiscal 2009 due primarily to a net gain on the extinguishment of debt of \$139.5 million and ECASLA put and lender fee income of \$19.6 million. This is a year over year increase of \$91.2 million from fiscal 2009, as compared to an increase of \$284.3 million from fiscal 2008 to fiscal 2009. The net gain on extinguishment of debt primarily came from three bond financings. Two of the transactions involved the purchase and subsequent extinguishment of \$819.2 and \$704.0 million of failed auction rate bonds from the 11th General Resolution at a discount. These two transactions resulted in gross gains of \$45.8 million and \$67.8 million respectively for a total gain of \$113.6 million. When adjusted for the write-off of unamortized costs of issuance associated with

the extinguished debt of \$2.7 million and \$3.0 million respectively, as well as a premium expense of \$0.2 million, the net gain related to these two transactions was \$107.7 million. Bond proceeds from the issuance of LFRNs under the 2010-1 and 2010-2 facilitated the 11th General bond purchases. The third transaction was related to the redemption of the 2005 Trust Indenture bonds, which resulted in a gross gain of \$24 million that when adjusted for the write-off of \$1.0 million in related unamortized costs of issuance, resulted in a net gain of \$23 million. Proceeds from the issuance of the LFRNs under the 2009-1 Trust and a Straight-A Conduit draw assisted in the redemption of the 2005 Trust. In addition to these three large transactions, the Authority also utilized cash contained in the various trusts to complete several smaller purchases at a discount, which contributed \$11.0 million in gross gains on the extinguishment of debt that when adjusted for the write-off of \$2.1 million in associated unamortized costs of issuance, provided a net gain of \$8.9 million.

When adjusted for the net gain on extinguishment of debt and the ECASLA put and lender fee income which totaled \$159.0 million the Authority's core operating revenue declined \$88.7 million or 46%. As indicated in detail below, changes in the special allowance subsidy program due to loan mix changes as well as the interest rate environment were the key components for the core operating revenue variance. The primary factor impacting the change in net assets before net gain on the extinguishment of debt and the ECASLA related income was the reduction in the lender yield on the Authority's assets, which is represented by the \$41.7 million decline in special allowance subsidy, the \$42.6 million reduction in interest income and the \$7.2 million reduction in interest subsidies totaling \$91.5 million, which exceeds the \$72.3 million reduction in interest expense on the bonds that finance those assets. Additionally, fiscal 2010 saw reductions of \$1.7 million in investment income due to a lower yield on investments during the period. Operating income in fiscal 2010 benefited from \$7.1 million in servicing fee revenue.

Total operating revenue increased 36% from fiscal 2009 to fiscal 2010 as compared to a 37% decrease from fiscal 2008 to fiscal 2009. As noted above the primary reason for the increase was related to the net gain on the extinguishment of debt. The decrease in special allowance is a result of the drop in the 90-day AA financial commercial paper rate (CP rate) from an average of 1.7% in fiscal 2009 to an average of 0.28% in fiscal 2010 and an increase in the percentage of loans in the portfolio subject to negative special allowance payments. For example, federal law requires the Authority to charge a parent an 8.5% interest rate on a PLUS loan originated after July 1, 2006, which the Authority collects from the parent borrower. However, the Authority only earns a yield on that loan at the CP rate plus 1.94%. The CP rate for quarter ended June 30, 2010 was just 0.41%, which means the Authority's annual yield for that quarter was only 2.35%. The Authority is required to rebate the additional interest paid by the borrower of 6.15% (8.5% - 2.35%) to the Department through the rebate of excess special allowance. Examples of the rates driving student loans and an explanation regarding 9.5% floor income follow in the next several paragraphs.

Fixed rate unsubsidized Stafford loans made on or after July 1, 2006 and subsidized Stafford loans made between July 1, 2006 and June 30, 2008 in all loan statuses bear interest at 6.8%. Fixed rate subsidized Stafford loans made between July 1, 2008 and June 30, 2009 bear interest at 6.0%, while the same loans made between July 1, 2009 and June 30, 2010 bear interest at 5.6%. Subsidized and unsubsidized Stafford loans made on or after July 1, 1998 and before July 1, 2006 that are in a status other than in-school, grace or deferment bear interest at a rate equivalent to the 91-day T-Bill rate plus 2.30%, with a maximum rate of 8.25%. Loans made within the same period with in-school, grace, and deferment status bear interest at a rate equivalent to the 91-day T-Bill rate plus 1.70%, with a maximum rate of 8.25%. The variable rate loans are adjusted annually on July 1 based on the 91-day T-Bill rate on the last auction date in May. During fiscal 2010, the rate on these loans was set at 2.48% and 1.88% respectively. The rate on the same loans during fiscal 2009 was 4.21% and 3.61% respectively and during fiscal 2008 was 7.22% and 6.62% respectively.

PLUS loans first disbursed on or after July 1, 2006 bear a fixed rate at 8.5%. Variable rate PLUS Loans made on or after July 1, 1998 bear interest at a rate equivalent to the 91-day T-Bill rate plus 3.10%, with a

maximum rate of 9%. The rates are adjusted annually on July 1 based on the 91-day T-Bill rate on the last auction date in May. The T-Bill rate used for fiscal 2010 was 0.18%, which set the rate at 3.28% as compared to 5.01% for fiscal 2009 and 8.02% for fiscal 2008. Consolidation Loans for which the application was received by an eligible lender on or after October 1, 1998, bear interest at a rate equal to the weighted average of the loans consolidated, rounded to the nearest higher one-eighth of 1%, with a maximum rate of 8.25%.

As noted above, the Authority realized a year over year reduction in special allowance subsidy issued by the Department to lenders participating in FFELP. The special allowance subsidy is paid on the spread between student loan borrower interest rates, which are relatively fixed for a year, and the commercial paper and 91-day T-Bill rates, which decreased significantly throughout fiscal 2008, fiscal 2009 and fiscal 2010. This decrease was in large part due to the falling 90-day AA financial commercial paper rates and the increase in the percentage of loans subject to the rebate of excess special allowance payments from 45% in fiscal 2009 to 57% in fiscal 2010. In addition, qualified loans within tax-exempt bonds issued prior to October 1993 are eligible to receive a subsidy based upon the greater of the same spread or 9.5%. However, in a Dear Colleague Letter issued on January 23, 2007, the Department clarified the requirements of the statute and regulations that control the qualifications for loans eligible for the 9.5% floor. The U.S. Department of Education provided further guidance on this clarification in a Dear Colleague Letter dated April 27, 2007. These requirements include a special audit to determine the eligibility for 9.5% special allowance billings. The Department paid special allowance at the standard rate on any loans that were included in the 9.5% minimum from quarter ending December 31, 2006 until the Department received the results of the special audit of the bonds and the loans within those bonds. This audit was completed and the Authority received a payment of \$0.8 million from the Department for the quarters ended December 31, 2006 through December 31, 2007. The principal balance of loans receiving 9.5% special allowance dropped from \$16.3 million in fiscal 2009 to \$5.1 million in fiscal 2010, which represents a drop of over 68%.

Total operating expense realized a 38% decrease, or \$71.4 million from fiscal 2009 to fiscal 2010 compared to a 38% decrease, or \$114.1 million from fiscal 2008 to fiscal 2009. The primary reason for the decline in operating expenses is the decline in bond interest expense from \$124.7 million in fiscal 2009 to \$51.9 million in fiscal 2010, which represents a decrease of 58%. While bond interest rates generally fell as broader market interest rates declined, these declines did not keep pace with the drop in yields on the Authority's assets. While not as significant as in fiscal 2009, the Authority continued to experience various interest rate spikes on its debt in fiscal 2010 due to the failure of the auction rate market, which set those bonds at the maximum rate under the bond documents. Bonds outstanding decreased by \$380.2 million primarily due to the purchase and extinguishment of bonds at a discount. As previously noted, the Authority issued \$186.0 million under the 2009-1 Trust, \$761.4 million under the 2010-1 Trust and \$822.5 million under the 2010-2 Trust. The Authority also borrowed \$282.0 million under the Straight-A Conduit and utilized \$468.8 million in short-term borrowings under the ECASLA Federal Loan Participation Purchase Program.

Another key factor in the decline in operating expenses before special items was a \$5.6 million decrease in consolidation rebate fees. However, this decline was partially off-set by a \$4.0 million increase in the provision for loan losses. During fiscal 2010, the Authority continued to experience increases in delinquencies in its supplemental loan portfolio as the percentage of supplemental loans over 120 days past due increased to 8.72% from 6.61% in fiscal 2009. During fiscal 2010 the Authority, charged-off an additional \$3.1 million in supplemental loans, net of recoveries that were over 270 days past due. In the FFELP portfolio, the Authority wrote-off \$0.2 million and provisioned \$0.6 million for probable losses.

Arbitrage rebate liability is calculated based upon the earnings of tax-exempt debt. The arbitrage liability was affected by decreased bond earnings and the further reduction of those earnings through student borrower benefit programs. During fiscal 2010, the Authority processed \$8.8 million in loan forgiveness that reduced arbitrage. The arbitrage rebate liability declined \$9.5 million in fiscal year 2010 to \$4.7 million compared to a

decrease of \$2.4 million in fiscal 2009. The reduction of arbitrage rebate liability produced \$0.7 million in income for fiscal 2010 compared to \$0.3 million in fiscal 2009.

Administrative and general expenses, which include salaries and fringe benefits, postage and forms, third party servicing fees, computer services, professional fees, occupancy expense, depreciation and other operating expenses; increased 9% compared to a 10% decline in fiscal 2009. Salaries and employee benefit related expenses increased by \$1.4 million or 9% from fiscal 2009 to fiscal 2010. Also contributing to the increase in Administrative and General Expenses was a \$0.9 million or 42% increase in other operating expenses. A 10% increase in computer services was predominantly offset by an 11% reduction in third party loan servicing.

While there were no special items in fiscal 2010, the fiscal 2009 special items were primarily related to the \$50 million in one-time gains from the cancellation of debt. In addition, the Authority also realized a \$1.5 million gain related to the termination of an excess pension benefit plan. The proceeds of the terminated plan were put into the Authority's regular pension benefit plan.

As noted above, the primary reason for the \$146.7 million increase in net assets was related to activity associated with the \$139.5 million net gain on extinguishment of debt. Restricted net assets increased by \$90.1 million from \$126.3 million in fiscal 2009 to \$216.4 million in fiscal 2010, while unrestricted net assets increased by \$56.8 million from \$27.9 million in fiscal 2009 to \$83.9 million in fiscal 2010. The one-time gains from the cancellation of debt were the key component to the \$75 million increase in restricted net assets from \$51 million in fiscal 2008 to \$126.3 million in fiscal 2009. The other components are directly related to the decline in unrestricted net assets, which fell from \$47 million in fiscal 2008 to \$26 million in fiscal 2009. This decline is the result of the Authority's equity contributions to the new 2008 Trust Indenture and the commercial paper conduit.

Continuing Developments

The Health Care and Education Reconciliation Act of 2010

On March 30, 2010, the Health Care and Education Reconciliation Act of 2010 ("HCEARA" or the "Reconciliation Act") was enacted into law. HCEARA includes a revised version of SAFRA ("The Student Aid and Fiscal Responsibility Act of 2009") previously adopted by the United States House of Representatives in September 2009, which also contained language terminating the origination of FFELP loans under FFELP by July 1, 2010. The Reconciliation Act eliminated FFELP effective July 1, 2010 and the origination of new FFELP loans after June 30, 2010. As of July 1, 2010, all loans made under the Higher Education Act will be originated under the Federal Direct Student Loan Program (the "Direct Loan Program"). The terms of existing FFELP loans are not materially affected by the Reconciliation Act.

Additionally HCEARA temporarily granted the Secretary authority to make a Federal Direct Consolidation Loan to a borrower (a) who has one or more loans in two or more of the following categories: (i) loans made under the Direct Loan Program, (ii) loans purchased by the Secretary pursuant to the provisions described herein under "—Secretary's Temporary Authority to Purchase Stafford Loans and PLUS Loans," and (iii) loans made under FFELP that are held by an eligible lender; (b) who has not yet entered repayment on one or more of such loans in any of the categories described in clause (a)(i)-(iii) herein; and (c) whose application for such Federal Direct Consolidation Loan is received by the Secretary on or after July 1, 2010 and before July 1, 2011.

As previously mentioned, the Authority is already pursuing a contract with the Department to service Direct Loan Program loans in accordance with HCEARA, Public Law 111-152, which requires the Secretary to contract with each eligible and qualified not-for-profit servicer to service loans. The Department has already

determined that the Authority meets the basic eligibility requirements for a not-for-profit servicer as outlined in HCERA with final determinations of eligibility and qualifications under the terms of the statute to be made as part of a future formal solicitation process. The Authority created a direct loan team in November 2009, which has subsequently hired 15 full-time staff including a Director of Federal Contracts as well as a consulting firm with considerable experience in student lending and federal government contracting.

The Ensuring Continued Access to Student Loans Act of 2008

On May 7, 2008, the President signed House Resolution 5715, the Ensuring Continued Access to Student Loans Act of 2008 ("ECASLA"). A key provision of the Act grants temporary authority to the Secretary of Education to purchase or enter into forward commitments to purchase student loans first disbursed under sections 428, 428B or 428H of the Act on or after October 1, 2003 and before July 1, 2009 on such terms as the Secretary determines are in the best interest of the United States. On October 7, 2008, the Participation and Purchase Programs were extended to September 30, 2010 for loans made in the 2009-2010 academic year.

The Department in implementing House Resolution 5715 has created two programs the Federal Family Education Loan Participation Purchase program and the Federal Family Education Loan Purchase Commitment program. The Authority filed its intent to participate in both programs on July 3, 2008 and July 23, 2009 for each program year respectively. The Authority also successfully encouraged many of its lender partners to file their intent to participate in both program years. The Authority began actively utilizing the ECASLA Loan Participation Purchase program in November 2008 for eligible Authority originated loans and the Authority has also utilized the program to purchase ECASLA eligible loans from its lender partners. In June 2009, the Authority completed its first put (sale of loans) of \$2.7 million in loans to the Department under the ECASLA Master Loan Sale Agreement. The Authority has continued to put loans to the Department with over \$1.4 billion put through September 17, 2010 and another \$1.2 million put is scheduled for October 15, 2010. The utilization of this program is the reason for the new classification of Student Loan Receivable Held for Sale on the Authority's Statement of Net Assets.

The Master Participation Agreement is designed to provide short-term liquidity to eligible lenders for the purpose of financing the origination of FFELP loans. Loans participated in the program are charged a rate of commercial paper plus 50 basis point on the principal amount. All loans under the Participation Program must be either refinanced by the lender or sold to the Department under the Purchase Program. The Master Loan Sale Agreement allows eligible lenders to sell FFELP loans originated for the 2008-2009 academic year to the Department through the Purchase Program at 101% plus \$75 per loan. The agreement expires on September 30, 2010.

In May 2009, the Department in conjunction with industry partners established the Asset-Backed Commercial Paper (ABCP) Conduit Program that will help ensure the continued availability of FFELP loans to students and parents for the 2009-2010 academic year. Participants in the Conduit Program must use 100 percent of the net proceeds of funds received from the Conduit to originate and disburse new FFELP loans. Loans eligible for the Conduit Program include Stafford and PLUS loans with first disbursement dates on or after October 1, 2003 and no later than June 30, 2009 and fully disbursed before September 30, 2009. The Department entered into a put agreement with the Straight-A Funding LLC Conduit using the authority provided by, and consistent with the requirements of ECASLA.

The Conduit purchases notes secured by eligible FFELP loans from eligible FFELP lenders and holders, which in turn serves as the underlying asset against which the Conduit sells commercial paper. The Conduit Program provides an advance of 97% of the student loan value. The commercial paper has variable maturities, but in no case longer than 90 days. As previously-issued commercial paper matures, proceeds from newly-issued commercial paper is used to satisfy investors holding earlier maturities. If necessary, the Federal

Financing Bank will provide a short-term liquidity backstop to re-finance maturing commercial paper. The Department will purchase loans from the Conduit in order to allow the Conduit to repay such short-term liquidity loans to the extent required. The Conduit Program has a term of five years and expires on November 19, 2013. On June 30, 2010, the Authority had \$282.1 million in loans funded through the Asset-Backed Commercial Paper Conduit Program.

Lewis and Clark Discovery Initiative

On August 28, 2007, legislation establishing the Lewis and Clark Discovery Initiative (the “Initiative”) became law. The legislation, known as Senate Bill 389 (the “LCDI Legislation”) directs the Authority to distribute \$350 million into a new fund in the State Treasury known as the Lewis and Clark Discovery Fund (“Fund”) on the following schedule: \$230 million no later than September 15, 2007; an additional \$5 million by December 31, 2007; and further installments of \$5 million each calendar quarter ending September 30, 2013. Investment earnings on the Fund are credited against subsequent payments by the Authority. In addition, the law provides that the Authority may delay payments if the Authority determines that any such distribution may materially adversely affect the service and benefits provided to Missouri students or residents in the ordinary course of the Authority’s business, the borrower benefit programs of the Authority or the economic viability of the Authority. However, the entire \$350 million is to be paid by September 30, 2013 unless otherwise approved by the Authority and the Missouri Commissioner of the Office of Administration. The General Assembly has appropriated amounts to be deposited in the Fund for certain capital projects at public colleges and universities.

The Authority receives a significant benefit pursuant to the LCDI Legislation. The new law provides that following the initial September 15, 2007 distribution by the Authority, the Missouri Director of Economic Development shall allocate to and reserve for the Authority in 2007 and the next 14 years at least 30% of Missouri’s tax-exempt, private activity bond cap allocation. This allocation was \$150 million for 2007. The amount of this allocation may be reduced for 2014 and later years by the percentage of the \$350 million not paid by the Authority to the Fund by the end of the preceding year.

On September 7, 2007 the Members of the Authority’s Board approved a resolution to fund the initial payment of \$230 million to the Lewis and Clark Discovery Fund in the Missouri State Treasury no later than September 14, 2007 pursuant to the terms of the new law relative to the LCDI Legislation. On September 14, 2007, in accordance with the Board’s Resolution and Missouri Senate Bill 389, the Authority sent a \$230 million wire to the Missouri State Treasury. On November 6, 2007, the Members of the Authority’s Board approved a resolution to fund the first quarterly payment of \$5 million less interest income earned on the funds on deposit with the State Treasurer. The net payment paid on December 31, 2007 was \$2.9 million. On March 28, 2008, the Members voted to make a partial payment for March 31, 2008, equivalent to the interest income already earned and on deposit in the fund at the State Treasurer’s Office. On June 26, 2008, the Board approved a resolution to make a payment of \$927 thousand, which after including interest income earned from December 1, 2007 through June 30, 2008 of \$4.1 million, results in the Authority making the full \$5 million payment that was due on March 31, 2008. The Board also voted on June 26, 2008 to delay making the June 30, 2008 quarterly payment. On September 12, 2008, the Board voted to make a partial quarterly payment on September 30, 2008 of \$0.1 million. For each subsequent quarterly payment through year ended June 30, 2010, the Board did not authorize payment. On July 21, 2010, the Authority received a two year extension from the Commissioner of the Office of Administration on the payment of LCDI funds to September 30, 2015. The two year extension was approved as a part of the Authority’s agreement to provide \$30 million in Missouri College Access funds for need based scholarships to the State during the 2011 Fiscal Year. This amount will partially offset dramatic reductions in scholarship funding by the State of Missouri due to budget shortfalls.

2005 Trust Indenture

On August 31, 2009, the Trustee for the 2005 Trust Estate filed a petition in Minnesota State Court asking the court to decide whether an event of default, an insurer adverse change and/or an automatic termination event has occurred under the 2005 Trust Indenture and/or its related documents. This petition was filed due to differing assertions by the parties to the transaction. This petition was dismissed on December 4, 2009 as the parties to the transaction worked collaboratively to complete the refinancing of the entire Trust on November 5, 2009. Additional information regarding this event can be found in the Financings Note 8.

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

STATEMENTS OF NET ASSETS AS OF JUNE 30, 2010 AND 2009 (Dollars in thousands)

	2010	2009		2010	2009
ASSETS			LIABILITIES AND NET ASSETS		
CURRENT ASSETS:			CURRENT LIABILITIES:		
Cash and cash equivalents:			Conduit payable	\$ 282,049	\$ 180,000
Restricted	\$ 107,738	\$ 25,331	Other liabilities	13,401	155,796
Unrestricted	134,983	120,032	Bonds payable	144,155	107,875
Total cash and cash equivalents	<u>242,721</u>	<u>145,363</u>	ECASLA payable	468,817	285,600
Student loans receivable	315,835	40,505	Accrued interest payable	4,618	12,398
Student loans receivable — available for sale	470,596	422,238	Special allowance subsidy payable	<u>37,105</u>	<u>41,467</u>
Accrued interest receivable:			Total current liabilities	<u>950,145</u>	<u>783,136</u>
Interest subsidy — U.S. Secretary of Education:	13,164	18,590	LONG-TERM LIABILITIES:		
Student loans receivable (less allowance for doubtful amounts,			Bonds payable	3,354,817	3,771,325
\$533 in 2010 and \$1,104 in 2009)	90,619	110,404	Arbitrage rebate payable	<u>4,725</u>	<u>14,195</u>
Student loans receivable — available for sale	9,061	7,825	Total long-term liabilities	<u>3,359,542</u>	<u>3,785,520</u>
Miscellaneous receivables and prepaid expenses	2,912	5,192	Total liabilities	<u>4,309,687</u>	<u>4,568,656</u>
Deferred charges	1,200	802	NET ASSETS:		
Total current assets	<u>1,146,108</u>	<u>750,919</u>	Invested in capital assets	14,045	14,182
LONG-TERM ASSETS:			Restricted	217,214	126,276
Student loans receivable (less allowance for doubtful			Unrestricted	<u>83,851</u>	<u>27,949</u>
loans, \$10,901 in 2010 and \$6,158 in 2009)	3,443,321	3,952,915	Total net assets	315,110	168,407
Pension asset	5,306	5,151			
Deferred charges, at cost less accumulated amortization of					
\$11,341 in 2010 and \$10,358 in 2009	16,017	13,896			
Capital assets, at cost less accumulated depreciation of					
\$7,187 in 2010 and \$6,140 in 2009	14,045	14,182			
Total long-term assets	<u>3,478,689</u>	<u>3,986,144</u>			
TOTAL	<u>\$4,624,797</u>	<u>\$4,737,063</u>	TOTAL	<u>\$4,624,797</u>	<u>\$4,737,063</u>

See notes to financial statements.

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2010 AND 2009

(Dollars in thousands)

	2010	2009
OPERATING REVENUES:		
Interest on student loans	\$ 156,349	\$ 198,906
U.S. Secretary of Education:		
Interest subsidy	31,272	38,498
Special allowance	(89,617)	(47,953)
Investment income — interest on cash, cash equivalents, and investments	310	1,975
Servicing fee	7,130	2,630
Gain on extinguishment of debt	139,461	-
ECASLA income	19,578	60
Total operating revenues	264,483	194,116
OPERATING EXPENSES:		
Interest expense	51,922	124,679
Bond maintenance fees	3,513	3,899
Letter of credit fees	3,075	2,443
Total bond related expenses	58,510	131,021
Consolidation fees	16,048	21,620
Origination fees	1,654	921
Default fee payments	106	518
Reduction of arbitrage rebate liability	(670)	(297)
Provision for loan losses	8,001	3,990
Total student loan related expenses	25,139	26,752
Salaries and employee benefits	16,935	15,517
Postage and forms	2,488	2,362
Third party servicing fees	3,031	3,397
Computer services	4,144	3,772
Professional fees	1,889	2,025
Occupancy expense	1,492	1,202
Depreciation	1,080	915
Other operating expenses	3,072	2,168
Total general and administrative expenses	34,131	31,358
Total operating expenses	117,780	189,131
OPERATING INCOME BEFORE SPECIAL ITEMS	146,703	4,985
SPECIAL ITEMS:		
Net gain on repurchase of bonds	-	49,911
Net gain on termination of excess benefit plan	-	1,543
Lewis and Clark distribution	-	(100)
CHANGE IN NET ASSETS	146,703	56,339
NET ASSETS — Beginning of year	168,407	112,068
NET ASSETS — End of year	\$ 315,110	\$ 168,407

See notes to financial statements.

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2010 AND 2009 (Dollars in thousands)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Student loan and interest purchases and originations	\$ (1,038,684)	\$ (717,493)
Cash received for sale of loans and interest	670,147	-
Student loan repayments	604,537	655,284
Payment to employees and vendors	(60,263)	(54,670)
Net settlement of government interest	(61,373)	22,778
Other	-	(9)
Net cash provided by (used in) operating activities	<u>114,364</u>	<u>(94,110)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from issuance of bonds	1,769,900	262,500
Proceeds from line of credit	-	78,518
Proceeds from conduit	308,719	79,000
Proceeds from ECASLA	872,345	289,913
Repayment of bonds	(2,025,849)	(115,799)
Interest paid on debt	(57,065)	(128,750)
Repayment on line of credit	-	(378,518)
Repayment on conduit	(206,670)	(44,500)
Repayment on ECASLA	(689,128)	(4,313)
Cash paid for bond issuance costs	(12,319)	(1,409)
Cash received for the extinguishment or cancellation of debt	24,000	79,797
Lewis and Clark distribution	-	(100)
Net cash (used in) provided by noncapital financing activities	<u>(16,067)</u>	<u>116,339</u>
CASH FLOWS FROM CAPITAL ACTIVITIES:		
Purchase of capital assets	(939)	(904)
Proceeds from sales of capital assets	-	14
Net cash used in capital activities	<u>(939)</u>	<u>(890)</u>
CHANGE IN CASH AND CASH EQUIVALENTS	97,358	21,339
CASH AND CASH EQUIVALENTS — Beginning of year	<u>145,363</u>	<u>124,024</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 242,721</u>	<u>\$ 145,363</u>

(Continued)

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2010 AND 2009 (Dollars in thousands)

	2010	2009
RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating income before special items	\$ 146,703	\$ 4,985
Adjustments to reconcile operating income before special items to net cash used in operating activities:		
Depreciation and amortization:		
Capital assets	1,080	915
Prepaid pension	263	187
Loan, letter of credit and bond fees	33,039	33,084
Provision for loan losses	8,001	3,990
Interest expense	60,740	122,528
Write-off of loans	3,426	2,523
Recoveries on supplemental loans	(168)	(299)
Reduction in arbitrage rebate liability	(670)	(297)
Cash received for the cancellation of debt	(24,000)	-
Gain on extinguishment of debt	(133,097)	-
Change in assets and liabilities:		
Decrease (increase) in student loans receivable	144,697	(323,481)
Decrease in accrued interest receivable	23,975	28,977
Increase in miscellaneous receivables and prepaid expenses and pension asset	(2,867)	(4,451)
Decrease (increase) in other liabilities, special allowance subsidy payable, and interest payable	(146,758)	37,229
Total adjustments	(32,339)	(99,095)
Net cash provided by operating activities	\$ 114,364	\$ (94,110)
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:		
Student loan principal and interest forgiveness	\$ 8,800	\$ 2,145
In-transit student loan purchases (including interest and premium)	-	145,110
Exchange of student loan receivables for the cancellation of debt	-	1,156,276

See notes to financial statements.

(Concluded)

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2010 AND 2009 (Dollars in thousands)

1. DESCRIPTION OF THE ORGANIZATION

Legislation, which was signed into law on June 15, 1981, by the Governor of the State of Missouri and became effective on September 28, 1981, created the Higher Education Loan Authority of the State of Missouri (the "Authority") for the purpose of providing a secondary market for loans made under the Federal Family Education Loan Program provided for by the Higher Education Act ("FFELP"). The legislation was amended, effective August 28, 1994, effective August 28, 2003, and again effective May 2, 2008, to provide the Authority with generally expanded powers to finance, originate, acquire, and service student loans, including, but not limited to, those guaranteed or insured pursuant to the Higher Education Act. The Authority is assigned to the Missouri Department of Higher Education. However, by statute, the State of Missouri is in no way financially accountable for the Authority. Student loan revenue bonds outstanding are payable as specified in the resolutions authorizing the sale of bonds. The bonds are not payable from funds received from taxation and are not debts of the State of Missouri or any of its other political subdivisions.

The Authority has also historically been one of the lenders for supplemental loans made available to students in the Midwestern region who have reached the maximum available under the FFELP. The balance of these loans outstanding is approximately 5% of the total loan receivable balance. During fiscal year 2008, the Authority discontinued originating supplemental and consolidated loans.

On March 30, 2010, the President signed into law The Health Care and Education Reconciliation Act of 2010, which included the Student Aid and Fiscal Responsibility Act ("SAFRA"). Effective July 1, 2010, the legislation eliminates the authority to provide new loans under FFELP and requires that all new federal loans are to be made through the Direct Loan Program ("DLP"). The new law does not alter or affect the terms and conditions of existing FFELP loans. The Authority will continue to service and purchase FFELP Loans. The Authority expects to be able to remain a going-concern while servicing the existing FFELP Loans currently on the statements of net assets. The Authority is currently in the process of restructuring its operations to reflect this change in law. The Authority has appointed a five member team from its senior management to lead the Direct Loan Servicing effort, and is diligently pursuing a Direct Loan servicing contract with the U.S. Department of Education.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Accounting — The Authority's financial statements have been prepared on the basis of the governmental enterprise fund concept which pertains to financial activities that operate similarly to a private business enterprise. The Authority's funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Authority has elected to apply all Financial Accounting Standards Board (FASB) statements and interpretations issued after November 1989 except those that conflict or contradict with GASB pronouncements.

In accordance with the bond and other borrowing resolutions, the Authority utilizes fund accounting principles, whereby each fund is a separate set of self-balancing accounts. The assets of each bond fund are restricted pursuant to the bond resolutions. To accomplish the various public purpose loan programs empowered by its authorizing legislation and to conform with the bond and note resolutions and indentures, the Authority records financial activities in the various operating and bond related funds (see Note 14). Administrative transactions and those loan transactions not associated with the Authority's bond issues are recorded in the Operating Fund. For financial statement presentation purposes, the funds have been aggregated into one proprietary fund type.

Use of Estimates — The preparation of the Authority's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the statement of net assets dates and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the arbitrage rebate payable, allowance for doubtful loans, and calculation of current and long-term student loans receivable and current and long-term bonds payable.

Cash Equivalents — The Authority considers all investment securities with original maturities of less than 90 days at the date of purchase to be cash equivalents. All cash equivalents whose proceeds are restricted for debt service reserve, the payment of rebate liabilities and payments to the State of Missouri for need-based scholarship funding (see Note 16) are classified as restricted cash equivalents (see Note 7).

Student Loans Receivable — Student loans receivables are stated at the principal amount outstanding adjusted for premiums. The related interest income generated from the loans is offset by premium amortization expense. Premiums on student loans are amortized over the estimated life of new loans purchased using a method that approximates the effective interest method. Because the Authority holds a large number of similar loans, the life of the loans can be estimated while considering expected amounts of prepayments from borrowers and loan consolidations. During the years ended June 30, 2010 and 2009, the estimated life of new loans purchased was three years. In addition, for the years ended June 30, 2010 and 2009, the Authority expensed all premiums for pools of loan purchases with less than \$40 of initial premiums.

Interest on student loans is accrued based upon the actual principal amount outstanding. The U.S. Secretary of Education makes quarterly interest payments on subsidized loans until the student is required, under the provisions of the Higher Education Act, to begin repayment. Repayment must begin generally within six months after the student completes his or her course of study, leaves school, or ceases to carry at least one-half the normal full-time academic load as determined by the participating institution.

The U.S. Secretary of Education provides a special allowance to student loan owners participating in the FFELP. The special allowance amount is the result of applying a percentage, based upon the average bond equivalent rates of the three-month financial Commercial Paper (CP) rate, to the average daily unpaid principal balance and capitalized interest of student loans held by the Authority. The special allowance is accrued as earned or payable. For loans first disbursed prior to January 1, 2000, the 91-day Treasury bill rate is used rather than the three-month financial CP rate.

The Authority as a loan owner, does not necessarily earn what a borrower pays. Special allowance was designed to ensure loan owners earned a market rate of interest by making up the difference between what a borrower pays in interest (borrower rate) under federal law and what a loan owner earns (lender

yield) on the loan under federal law. Borrower interest rates for Stafford and PLUS loans first disbursed between July 1, 1998 and June 30, 2006 were variable rates set annually based on the 91-day Treasury bill plus a spread of 1.70% to 3.10%. Lender yields on many of those same loans (loans first disbursed between January 1, 2000 and April 1, 2006) adjust quarterly based on the 90-day AA CP rate plus a spread of between 1.74% and 2.64%, however, the borrower rate serves as the “floor” for the lender yield. Loans first disbursed in these time periods can only earn positive special allowance due to the “floor” income feature. However, for loans first disbursed after April 1, 2006 federal law changed, removing the “floor” income feature, which allows the lender yield to float down below the borrower rate. In these situations the loan owner earns less than the borrower pays in interest causing negative special allowance, which must be rebated to the U. S. Department of Education. This situation was magnified by additional change in federal law that implemented fixed borrower interest rates from 6.8% to 8.5% for loans first disbursed after July 1, 2006. Furthermore for loans first disbursed after October 1, 2007, the spread lender’s receive over the CP rate was reduced by 40 to 70 basis points. The Authority’s total special allowance was negative in fiscal 2010 and 2009 due the Authority’s loan portfolio mix and the decline in the CP rate.

Student Loans Receivable Available for Sale — Loans classified as student loans receivable available for sale are loans which have been placed into the Ensuring Continued Access to Student Loan Act of 2008 (“ECASLA”) Participation Program or were purchased with the intent to place the loans into the ECASLA Participation Program. Student loans that are placed into the ECASLA Participation Program must be either refinanced by the Authority or sold to the Department of Education under the Purchase Program by the end of the program year. The intent of the Authority is to sell loans in the Participation Program to the Department under the Purchase Program.

Allowance for Doubtful Loans — The Authority has established an allowance for doubtful loans that is an estimate of probable losses incurred in the FFELP and supplemental loan portfolios at the statements of net assets date. The Authority presents student loans net of the allowance on the statements of net assets. Estimated probable losses are expensed through the provision for loan losses in the period that the loss event occurs. Estimated probable losses contemplate expected recoveries. When a charge-off event occurs, the carrying value of the loan is charged to the allowance for doubtful loans. The amount attributable to expected recoveries remains in the allowance for doubtful loans until received.

The supplemental loans in the Authority’s portfolio present the greatest risk of loan loss since the loans are either self-insured or insured by a third-party as opposed to the United States Department of Education, who insures FFELP loans. As such, in evaluating the adequacy of the allowance for doubtful loans on the supplemental loan portfolio, the Authority considers several factors including the loan’s insured status and the age of the receivable. When calculating the allowance for doubtful loans for the supplemental loan portfolio, the Authority’s methodology divides the portfolio into categories of similar risk characteristics based on insured status and age of the receivable. The Authority then applies default and recovery rate projections to each category. Supplemental loan principal is charged off against the allowance when the loan exceeds 270 days delinquency. Subsequent recoveries on loans charged off are recorded directly to the allowance.

The Authority utilizes true write-offs experienced over the three preceding years to estimate the current year allowance on the FFELP loans. Up to 98% of the principal and interest within the Authority’s FFELP loan portfolio is conditionally guaranteed by the Department of Education.

The allowance associated with the accrued interest receivable on student loans represents an allowance on the interest receivable on the supplemental loan portfolio consistent with the allowance for doubtful loans on the supplemental loan portfolio described above.

Miscellaneous Receivables and Prepaid Expenses — Miscellaneous receivables and prepaid expenses consist primarily of prepaid bond interest expense, receivables for servicing fees, and prepaid letter of credit fees.

Deferred Charges — Deferred charges consist of bond issuance costs. Deferred charges are amortized over the life of the bonds using a method that produces substantially the same results as the effective interest method.

Capital Assets — Capital assets consist of land, building, and office furniture and equipment recorded at cost. The Authority's policy is to capitalize all expenditures in excess of \$10. Depreciation is charged to operations on the straight-line method over the estimated useful lives of the related assets, which is 30 years for the building and generally five years for all other asset classes. The Authority reviews capital assets for impairment in accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.

Arbitrage Rebate — Federal income tax rules limit the investment and loan yields which the Authority may retain for its own use when investing the proceeds from certain of its tax-exempt bond issues. The excess investment and loan yields are payable to the U.S. Treasury and are accrued in the accompanying statements of net assets. Excess loan yields may also be reduced by certain borrower benefit programs.

Net Assets — The net assets of the Authority are classified into three categories: unrestricted, restricted and invested in capital assets. Unrestricted net assets include net assets available for the operations of the Authority and other activities accounted for in either the Operating Fund or the Bond Funds. Unrestricted net assets accounted for in the Bond Funds are pledged and subject to the requirements of the Bond Funds in which those unrestricted net assets are maintained. Removal of unrestricted net assets from the Bond Funds are typically subject to the approval of one or more of the following: credit rating agencies, bond insurers, letter of credit providers, bondholders and/or the trustee. Furthermore, extensive financial analysis is required and performed by the Authority and the approving party prior to the approval and removal of net assets. Restricted net assets consist of the minimum collateral requirements discussed in Note 7, net of related liabilities, as defined in the bond resolutions. The net assets invested in capital assets are discussed in Note 6.

Operating Revenues and Expenses — While bond and note issuance has historically been the principal source of the funds necessary to carry out the purposes of the Authority, which are to originate and acquire student loans, during the last two years the Authority has relied extensively on Federal ECASLA programs to carry out its purpose. The Authority's revenue is derived primarily from income on student loans and results on the extinguishment of outstanding bonds payable. Secondary sources of revenue include subsidies from put and lender fees associated with ECASLA programs, servicing fee revenue, and investment income. The primary cost of the program is interest expense on bonds and other borrowings outstanding. Therefore loan income, net investment income and interest expense are shown as operating revenues and expenses in the statements of revenues, expenses, and changes in net assets.

Gain on Extinguishment of Debt — Gains on extinguishment of debt represents the net result of the Authority's efforts to purchase and extinguish previously issued bonds. Gains resulting from the purchase and extinguishment of bonds at a discount to carrying value and are off-set by the write-off of previously unamortized bond issuance costs and premiums on the purchased bonds.

ECASLA Income — In August 2008, the Department of Education implemented the Purchase Program pursuant to ECASLA. Under the Purchase Program, the Department of Education purchases eligible FFELP loans at a price equal to the sum of (i) par value, (ii) accrued interest, (iii) the one-percent

origination fee paid to the Department of Education, and (iv) a fixed amount of \$75 per loan. ECASLA income is earned from the Purchase Program.

Servicing Fee Revenue — The Authority provides services to lending institutions for guarantee processing, loan origination, loan disbursement and loan servicing with respect to student loans. Fees charged for these services are classified as Servicing Fee.

Interest Expense — Interest expense primarily includes scheduled interest payments on bonds and other borrowings as well as accretion of bond discounts, broker commission fees, repricing fees, and auction agent fees.

Consolidation Fees — The Authority must remit each month to the U.S. Department of Education (the “Department”) an interest payment rebate fee for all of its Federal consolidation loans made on or after October 1, 1993. This fee is equal to 1.05% per annum of the unpaid principal balance and accrued interest of the loans. For loans made from applications received during the period beginning October 1, 1998 through January 31, 1999, inclusive, this fee is equal to 0.62% per annum of the principal and accrued interest of the loans. This fee is not and cannot be charged to the borrower.

Origination Fees — The Department charges lenders an origination fee based on the principal amount of each FFELP loan originated. The fee is paid to the Department and cannot be charged to the borrower. For loans first disbursed on or after October 1, 2007, the fee is 1% of the principal loan amount.

Bond Maintenance Fees — Bond maintenance fees consist primarily of rating agency fees, trustee fees and custodian fees.

Special Items — Special items represent significant transactions or other events within the control of management that are either unusual in nature or infrequent in occurrence. Special items are discussed further in Note 15.

Risk Management — The Authority is exposed to various risks of loss related to property loss, torts, cyber liability, errors and omissions and employee injuries. Coverage for these various risks of loss is obtained through commercial insurance. There has been no significant reduction in insurance coverage from coverage in the prior year for all categories of risk. Settlements have not exceeded insurance coverage for the past three fiscal years. Commercial insurance is purchased in an amount that is sufficient to cover the Authority’s risk of loss. The Authority will record an estimated loss related to a loss contingency as an expense and a liability if it meets the following requirements: (1) information available before the financial statements are issued indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and (2) the amount of the loss can be reasonably estimated.

Income Taxes — The Authority is a tax-exempt organization under the provisions of the Internal Revenue Code and accordingly, no provision for income taxes has been made in the accompanying financial statements.

3. CASH AND CASH EQUIVALENTS

At June 30, 2010 and 2009, the Authority’s carrying amount of cash on deposit was \$78,375 and \$15,595, respectively. The bank balance of deposits are insured by the FDIC and through a security interest with Bank of America with Bank of New York Mellon as custodian. The security interest was

invested in Government National Morgan Association notes at June 30, 2010. Other security types available to the Authority include U.S. Treasuries and general obligation bonds of the State of Missouri.

At June 30, 2010 and 2009, the Authority's cash equivalent balances of \$164,346 and \$129,768, respectively, represented investments in money market funds with credit ratings of AAAm.

4. INVESTMENTS HELD BY TRUSTEE

State law limits investments to any obligations of the State of Missouri or of the United States government, or any instrumentality thereof, certificates of deposit or time deposits of federally insured banks, or federally insured savings and loan associations, or of insured credit unions, or, with respect to moneys pledged or held under a trust estate or otherwise available for the owners of bonds or other forms of indebtedness, any investment authorized under the bond resolution governing the security and payment of such obligations or repurchase agreements for the specified investments.

As of June 30, 2010 and 2009, the Authority held no investments.

5. STUDENT LOANS RECEIVABLE

Student loans receivable are insured namely by the Missouri Department of Higher Education (MDHE), American Education Services (AES), the Student Loan Guarantee Foundation of Arkansas (SLGFA), United Student Aid Funds, Inc. (USA Funds), the National Student Loan Program (NSLP), the California Student Aid Commission (CSAC), the Tennessee Student Assistance Corporation (TSAC), the American Student Assistance (ASA), the Kentucky Higher Education Assistance Authority (KHEAA), the New York State Higher Education Services Corporation (NYSHESC), the Texas Guaranteed Student Loan Corporation (TGS LC), the Illinois Student Assistance Commission (ISAC), the Education Assistance Corporation (EAC), the Educational Credit Management Corporation (ECMC), the Northwest Education Loan Association (NELA), the Great Lakes Higher Education Corporation (GLHEC), or by other non-profit or state organizations, as to principal and accrued interest to the fullest extent allowed under current law. The supplemental loans are not federally insured.

Student loans receivable at June 30, 2010 and 2009, are as follows:

	2010	2009
MDHE	\$ 2,278,641	\$ 2,259,315
AES	482,771	517,321
SLGFA	232,499	263,491
USA FUNDS	231,988	249,285
NSLP	155,669	166,214
CSAC	128,275	144,963
TSAC	94,535	105,925
ASA	94,312	105,637
TGSLC	63,965	112,004
NYSHESC	53,346	55,754
GLHEC	50,419	17,457
KHEAA	46,304	53,240
ECMC	39,548	28,302
ISAC	29,820	26,503
NELA	11,286	12,437
EAC	2	35,378
Other	20,744	31,109
	<u>4,014,124</u>	<u>4,184,335</u>
Total federal loans		
Supplemental loans:		
Third party insured	14,982	18,440
Self-insured	211,547	219,041
	<u>226,529</u>	<u>237,481</u>
Total supplemental loans		
Allowance for doubtful loans	<u>(10,901)</u>	<u>(6,158)</u>
Total student loans receivable	<u>\$ 4,229,752</u>	<u>\$ 4,415,658</u>
Weighted average yield — end of year	<u>5.62 %</u>	<u>5.26 %</u>

The Authority's yield on federal student loan receivables is set by federal law and is generally variable based on either 90-day AA CP rate or the 91-day Treasury bill, plus a factor. These yields are based on the type of loan, the date of loan origination and in some cases, the method of financing. Consolidation loans, Stafford loans, and Parental Loans for Undergraduate Students (PLUS loans), originated after July 1, 2006, have a fixed rate for the borrower. The Authority's yield on supplemental loans are variable rate, based on either the Treasury bill or the prime rate, plus a factor, depending on when the loan originated and the credit worthiness of the borrower and/or co-signor.

The activity for the allowance for doubtful loans for the years ended June 30, 2010 and 2009, is as follows:

	2010	2009
Beginning balance	\$ 6,158	\$ 4,392
Provision for loan losses	8,001	3,990
Write offs of loans	(3,426)	(2,523)
Recoveries	<u>168</u>	<u>299</u>
	<u>\$ 10,901</u>	<u>\$ 6,158</u>

6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2010, is as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Land	<u>\$ 3,304</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,304</u>
Depreciable capital assets:				
Building	11,972	88		12,060
Furniture and equipment	<u>5,046</u>	<u>863</u>	<u>(41)</u>	<u>5,868</u>
Total depreciable capital assets	<u>17,018</u>	<u>951</u>	<u>(41)</u>	<u>17,928</u>
Less accumulated depreciation:				
Building	2,844	417		3,261
Furniture and equipment	<u>3,296</u>	<u>663</u>	<u>(33)</u>	<u>3,926</u>
	<u>6,140</u>	<u>1,080</u>	<u>(33)</u>	<u>7,187</u>
Net depreciable capital assets	<u>10,878</u>	<u>(129)</u>	<u>(8)</u>	<u>10,741</u>
Total	<u><u>\$ 14,182</u></u>	<u><u>\$ (129)</u></u>	<u><u>\$ (8)</u></u>	<u><u>\$ 14,045</u></u>

Capital asset activity for the year ended June 30, 2009, is as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Land	<u>\$ 3,304</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,304</u>
Depreciable capital assets:				
Building	11,746	226	-	11,972
Furniture and equipment	<u>4,392</u>	<u>678</u>	<u>(24)</u>	<u>5,046</u>
Total depreciable capital assets	<u>16,138</u>	<u>904</u>	<u>(24)</u>	<u>17,018</u>
Less accumulated depreciation:				
Building	2,433	411	-	2,844
Furniture and equipment	<u>2,807</u>	<u>504</u>	<u>(15)</u>	<u>3,296</u>
	<u>5,240</u>	<u>915</u>	<u>(15)</u>	<u>6,140</u>
Net depreciable capital assets	<u>10,898</u>	<u>(11)</u>	<u>(9)</u>	<u>10,878</u>
Total	<u><u>\$ 14,202</u></u>	<u><u>\$ (11)</u></u>	<u><u>\$ (9)</u></u>	<u><u>\$ 14,182</u></u>

7. BONDS PAYABLE

The following table displays the aggregate changes in bonds payable for fiscal years ended June 30:

	2010	2009
Beginning bonds payable	\$ 3,879,200	\$ 4,888,775
Additions	1,769,900	262,500
Repayments	(51,405)	(115,799)
Bonds purchased and subsequently extinguished	(2,098,723)	-
Cancellation of debt	<u>-</u>	<u>(1,156,276)</u>
Ending bonds payable	<u>\$ 3,498,972</u>	<u>\$ 3,879,200</u>

Bonds payable at June 30 consist of:

	2010	2009
Student loan revenue bonds, variable interest rates ranging from 0% to 4.37% at June 30, 2010, and 0% to 7.86% at June 30, 2009, maturing through 2046	\$3,498,972	\$3,770,850
Student loan revenue bonds, fixed interest rates ranging from 4.10% to 5.85% at June 30, 2009	<u>-</u>	<u>108,350</u>
Total student loan revenue bonds	<u>\$3,498,972</u>	<u>\$3,879,200</u>
Weighted average rate	<u>1.12 %</u>	<u>1.24 %</u>

The following is a summary of debt service requirements at June 30:

Fiscal Years	Principal	Interest	Total
2011	\$ 144,155	\$ 40,188	\$ 184,343
2012	130,351	38,265	168,616
2013	137,387	36,388	173,775
2014	139,741	34,445	174,186
2015	<u>139,150</u>	<u>32,491</u>	<u>171,641</u>
Total fiscal years 2011–2015	690,784	181,777	872,561
2016–2020	1,382,645	121,434	1,504,079
2021–2025	435,663	87,891	523,554
2026–2030	246,433	70,987	317,420
2031–2035	190,427	51,029	241,456
2036–2040	38,895	45,020	83,915
2041–2045	409,025	34,276	443,301
2046	<u>105,100</u>	<u>1,780</u>	<u>106,880</u>
	<u>\$3,498,972</u>	<u>\$594,194</u>	<u>\$4,093,166</u>

Variable student loan revenue bonds consist of variable rate demand notes, auction rate notes, LIBOR indexed rate notes (LIRNs) and LIBOR floating rate notes. Variable rate demand notes bear interest at a

rate determined by the remarketing agent. Such rate is determined every 7 days. The remarketing agent is authorized to use its best efforts to sell the repurchased bonds at a price equal to 100% of the principal amount by adjusting the interest rate. The repricing fee is expensed as incurred and included within interest expense on the statements of revenues, expenses, and changes in net assets. Auction rate notes, which represent 18% of the outstanding variable rate debt, bear interest at the applicable auction rate as determined by a bidding process every 7, 28, or 35 days as stipulated in the related Bond Agreement. Starting in November 2007 and continuing through June 30, 2010, the auction rate notes experienced failures in the bidding process. As of June 30, 2010, due to the failures in the auction market, the interest rate was calculated based upon the rate provisions as stipulated in the Bond Agreements and amended by supplemental resolutions agreed to by the Authority. The interest rates continued to reprice every 7, 28 or 35 days under a failed auction but were determined based upon a 91-Day Treasury Bill (T-Bill) indexed rate for taxable debt or a JJ Kenny indexed rate for tax-exempt debt taken in consideration with the annual average auction rate as of the current repricing date. The Authority's LIRN are variable rate notes that reprice monthly based on one month LIBOR plus 13 basis points. The Authority also has three outstanding LFRN trusts that reprice every three months at spreads to three month LIBOR ranging from 60 to 105 basis points. The debt service requirements in the table above were prepared using the applicable variable rates on June 30, 2010, and may significantly differ from the rates paid in future periods.

Certain bonds are subject to redemption or rate period adjustment at the discretion of the Authority under certain conditions as set forth in the Bond Agreement. In addition, at June 30, 2010, \$225,050 of the bonds are subordinate to the remainder of the outstanding bonds.

Bonds of each series are secured by (a) a pledge of proceeds derived from the sale of the bonds, (b) eligible loans, and (c) certain accounts established by the respective bond resolutions, including moneys and securities therein. For certain bonds, the Authority has entered into agreements with the Municipal Bond Investors Assurance Corporation, Bank of America N.A., and AMBAC Indemnity, whereby the parties have issued standby bond purchase agreements, letters of credit, or insurance policies to the Trustees as beneficiaries for the respective bondholders. The purpose of the standby bond purchase agreements, letters of credit or insurance policies is to provide liquidity to bondholders, and or guarantee payment of the bonds upon maturity or earlier redemption. The agreements contain certain covenants which, among other requirements, include minimum collateral requirements. The Authority maintains a minimum amount of assets pledged under required bond resolutions. The total of all minimum requirements for all bond issuances at June 30, 2010 and 2009, is \$3,672,652 and \$4,021,977, respectively. At June 30, 2010 and 2009, the Authority was in compliance with all financial covenants.

The respective bond resolutions establish the following special trust accounts for each bond series, unless otherwise indicated:

Loan Accounts — The loan accounts are used to account for the proceeds of bond issues not required to be deposited in the debt service reserve accounts. Generally, amounts in the loan accounts may be expended (a) to finance eligible student loans, (b) to pay bond issue costs, (c) to make deposits to the revenue accounts for the purpose of paying principal and/or interest on the bonds, and (d) to pay letter of credit fees.

Revenue Accounts — The revenue accounts are used to account for all revenues received by the Authority. Generally, amounts in the revenue accounts are used (a) to make principal and/or interest payments on the bonds, (b) to fund debt service reserve accounts, (c) to pay estimated program expenses to the operating account, and (d) to reimburse the issuers of letters of credit guaranteeing the bonds for amounts committed under the letters of credit. Excess amounts in the revenue account may be transferred to the loan accounts or to optional redemption accounts.

Operating Accounts — Amounts deposited in operating accounts are used to pay reasonable and necessary program expenses for the bond issues.

Debt Service Reserve Accounts — Under the terms of certain bond provisions, minimum amounts are required to be maintained in the debt service reserve accounts for related bond series. The total of these minimum requirements at June 30, 2010 and 2009, were \$6,001 and \$17,037, respectively. These funds are only to be used to make principal and/or interest payments on the bonds and any interest due on the borrowed funds. In accordance with the bond provisions, the Authority has purchased a non-cancelable Surety Bond in lieu of cash deposits in the debt service reserve accounts for certain of the bond obligations in the amount of \$5,756 and \$6,614 at June 30, 2010 and 2009, respectively. Such Surety Bonds expire on the earlier of the bond maturity date or the date in which the Authority satisfies all required payments related to such bond obligations. Under the ECASLA Federal Loan Participation Purchase Program funds received in the account are owed directly to the Department to pay principal and interest.

Rebate Accounts — Amounts deposited in the rebate accounts are used to pay the United States Treasury amounts required by Section 148 of the Internal Revenue Code.

The LFRNs issued in the 2009-1, 2010-1 and 2010-2 Trusts establish the following special trust accounts:

Collection Fund — Used to pay servicing administration fees, consolidated rebate fees, trustee fees, debt service, and make principal payments. Funds can also be used to re-instate the Reserve and Department Rebate Fund Accounts as required.

Reserve Accounts — Under the terms of certain bond provisions, minimum amounts are required to be maintained in the reserve accounts for related bond series. The total of these minimum requirements at June 30, 2010 was \$4,349.

Capitalized Interest Funds — Used to pay certain service, administrative, and other fees not available to be paid from the Collection Account.

Rebate Accounts — Used to pay negative special allowance and consolidation rebate fees.

Acquisition Funds — Used initially to account for loans transferred to the trust and or pay cost of issuance due within sixty days of closing.

The Straight-A Conduit establishes the following accounts:

Collateral Accounts — Amounts deposited in this account are used to make payments for purchases of delinquent loans and associated special allowance.

Rebate Accounts — Amounts deposited in this account are used to make payments for negative special allowance.

Reserve Accounts — Under the terms of the Straight-A Conduit Program certain amounts are required to be maintained in the Reserve Account equal to 1% of the Principal Balance of the Financed Student Loans.

Collection Accounts — The Collection Account is used to account for receipt of borrower payments, pay financing costs, servicing fees, principal and to fund the DOE Reserve Account for special allowance payments.

As of June 30, 2010 and 2009, cash and cash equivalents were segregated as follows:

	2010	2009
Special trust accounts:		
Unrestricted:		
Loan accounts	\$ -	\$ 61,635
Collection fund	4,613	-
Revenue accounts	66,115	30,653
Operating accounts	3,274	782
Restricted:		
Debt service reserve accounts	9,341	24,769
Reserve accounts	7,442	-
Capitalized interest funds	18,486	-
Acquisition funds	142	-
Collection accounts	36,237	-
Collateral accounts	921	-
Rebate accounts	5,166	562
	<u>151,737</u>	<u>118,401</u>
Total special trust accounts		
Operating fund:		
Unrestricted	52,944	14,500
Due to special trust accounts	8,037	12,462
Restricted	30,003	-
	<u>90,984</u>	<u>26,962</u>
Total operating fund		
Total cash and cash equivalents	<u>\$ 242,721</u>	<u>\$ 145,363</u>

8. FINANCINGS

Straight-A Conduit Program — In May 2009, the Department issued the Asset-Backed Commercial Paper (“ABCP”) Conduit Program to help ensure the continued availability of FFELP loans to students and parents for the 2009-2010 academic year. Participants in the Conduit Program must use 100 percent of the net proceeds of funds received from the Conduit to originate and disburse new FFELP loans. Loans eligible for the Conduit Program include Stafford and PLUS loans with first disbursement dates on or after October 1, 2003 and no later than June 30, 2009, which are fully disbursed before September 30, 2009. The Department entered into a PUT Agreement with the Straight-A Funding LLC Conduit (“Straight-A Conduit”) using the authority provided by, and consistent with the requirements of the ECASLA.

The Straight-A Conduit will purchase notes secured by eligible FFELP loans from eligible FFELP lenders and holders, which in turn will serve as the underlying asset against which the conduit sells commercial paper. The commercial paper will have variable maturities, but in no case longer than 90 days. As previously-issued commercial paper matures, proceeds from newly-issued commercial paper will be used to satisfy investors holding earlier maturities. If necessary, the Federal Financing

Bank will provide a short-term liquidity backstop to re-finance maturing commercial paper. The Department will purchase loans from the conduit in order to allow the conduit to repay such short-term liquidity loans to the extent required. The Straight-A Conduit provides an advance of 97 percent of the student loan value for loans in the program. The term of the Straight-A Conduit is five years and expires on November 19, 2013. However, due to the short term nature of the commercial paper sold by the Straight-A Conduit, the Straight-A Conduit is classified as a current liability within the statement of net assets. On July 30, 2009, the Authority funded \$190,158 in loans through the Straight-A Conduit. The Authority used this draw to refinance its multi-seller asset backed conduit that was originally entered into on July 26, 2007. On October 30, 2009, the Authority funded an additional \$118,561 in loans through the Straight-A Conduit to refinance eligible assets held under the 2005 Trust. As of June 30, 2010, the Authority had \$282,049 in loans outstanding under the Straight-A Conduit.

Conduit — On July 26, 2007, the Authority entered into an amended financing agreement for a \$250,000 multi-seller asset backed commercial paper conduit (the “Conduit”). On November 23, 2007, the Authority amended the agreement to increase the Conduit to \$500,000. On July 24, 2008, the Authority entered into an amended financing agreement for a \$500,000 multi-seller asset backed commercial paper conduit. On October 16, 2008, the financing agreement was amended to reduce the facility limit to \$375,000. As a result of a margin call by the bank demanding more equity which the Authority could not meet, the facility was amended on December 23, 2008. The amendment reduced the facility limit to \$250,000 with a payout schedule through July 2009. On July 23, 2009, the Authority entered into an agreement to extend the termination date on the asset back commercial paper conduit to August 21, 2009, under the same terms present in the original agreement. On July 30, 2009, the asset back commercial paper conduit was paid in full.

Line of Credit — The Authority had a \$300,000 revolving credit facility with a financial institution. The facility was to terminate on September 30, 2008. On September 30, 2008, the Authority entered into an amended financing agreement for the credit facility to extend the termination date to October 31, 2008, under the same terms present in the original agreement. The revolving credit facility was paid in full and terminated on October 16, 2008.

For the years ended June 30, 2010 and 2009, the following table displays the aggregate changes in the Conduit, Straight-A Conduit, and line of credit borrowings:

	2010	2009
Beginning balance	\$ 180,000	\$ 445,500
Additional borrowings	308,719	157,518
Repayments	<u>(206,670)</u>	<u>(423,018)</u>
Ending balance	<u>\$ 282,049</u>	<u>\$ 180,000</u>
Yield at end of year	<u>1.12%</u>	<u>0.50%</u>

The Ensuring Continued Access to Student Loans Act — Participation and Purchase Programs — On May 7, 2008, U.S. House Resolution 5715, the Ensuring Continued Access to Student Loans Act (“ECASLA”) was signed. The Act gives the U.S. Department of Education the authority to advance funds and enter into forward purchase commitments with qualifying lenders for the purchase of FFELP loans.

The Master Participation Agreement is designed to provide short-term liquidity to eligible lenders for the purpose of financing the origination of FFELP loans. Loans participated in the program are charged

a rate of commercial paper plus 50 basis point on the principal amount. All loans under the Participation Program must be either refinanced by the lender or sold to the Department under the Purchase Program. This ECASLA participation line of credit for the 2009-10 program year is available to the Authority until October 15, 2010. At June 30, 2010, the Authority had \$470,596 in loans under the Participation Program, which are classified as available for sale on the statement of net assets. Loans classified as available for sale on the statement of net assets were funded through the ECASLA payable current liability on the statement of net assets. Loans classified as available for sale are expected to be sold to the Department under the Purchase Program in the year ending June 30, 2011.

The Master Loan Sale Agreement allows eligible lenders to sell FFELP loans originated for the 2009–2010 academic year to the Department of Education through the Purchase Program at 101% plus \$75 per loan. Any lender participating must represent to the Department that it will continue to participate in the FFELP program. During the year ended June 30, 2010, the Authority sold \$704,968 in loans and accrued interest to the Department under the Purchase Program.

Bridge Financing — On June 24, 2009, the Authority entered into a new \$80,000 revolving line of credit with three banks to serve as a “bridge” financing for the Authority’s utilization of the ECASLA Federal Loan Participation Program. The interest rate is based on three options from which the Authority may choose: (i) Base Rate Option, based on the highest of (a) the Federal Funds Open Rate, plus 0.5%, and (b) the Prime Rate, and (c) the Daily LIBOR Rate, plus 100 basis points (1.0%) (ii) LIBOR Rate Option, or (iii) Daily LIBOR Rate Option. Different Interest Rate Options and different Interest Periods may be selected simultaneously for the loans comprising different borrowing tranches. Unused fee on the facility is 0.25%. The line of credit, which was scheduled to expire on June 23, 2010, was terminated by the Authority on May 24, 2010 because the facility was no longer needed.

2009-1 LIBOR Floating Rate Notes — On November 5, 2009, the Authority issued and privately placed \$186,000 in LIBOR floating rate notes to refinance the non Straight-A Conduit eligible assets from the 2005 Trust, which were primarily consolidation loans. The notes are full turbo, requiring all revenues in excess of required expenses to be used to reduce the outstanding principal balance. The notes had a starting parity of 105.44%, and were issued in two series as follows: Series A-1 for \$67,700 at three month LIBOR plus 0.60% with a expected weighted average life of 3.0 years and a final maturity of August 25, 2019, as well as, Series A-2 for \$118,300 at three month LIBOR plus 1.05% with a expected weighted average life of 10.99 years and a final maturity of February 25, 2036. The expected weighted average life was calculated based on a two percent constant prepayment rate (CPR). The 2005 Trust was a tax-exempt variable rate demand note (VRDN) backed by a synthetic letter of credit, with a standby bond purchase agreement and bond insurance. The interest rate on the VRDN was variable and prior to the credit market crisis, when the product functioned properly the remarketing rate that the bonds reset at was a rate that tracked closely with the SIFMA index (variable rate municipal bond index). Because of downgrades to the bond insurer, most of the bondholders put the bonds to the standby liquidity provider and the bonds became term bank bonds. As bank bonds, the interest rate of the bonds became a variable rate based on prime plus 1%. Given the low variable rate yield on the underlying assets and the higher cost of funds for the bonds based on prime, the trust began operating at a negative spread. These events also caused the bond maturity to change from 35 years to 5 years with mandatory semi-annual principal payments in eight equal installments beginning one year after the bonds became bank bonds. The Authority was able to work with the transaction parties to restructure the failed VRDN by financing the Straight-A Conduit eligible loans held by the trust into the Straight-A Conduit and to finance the remaining non-conduit eligible loans into the 2009-1 LIBOR floating rate notes. As previously stated, the transaction resulted in a gross gain of \$24,000 that when adjusted for the write-off of \$1,000 in related unamortized costs of issuance, resulted in a net gain of \$23,000. Proceeds from the issuance of the LFRNs under 2009-1 Trust and a Straight-A Conduit draw assisted in the extinguishment of the 2005 trust.

2010-1 LIBOR Floating Rate Notes — On January 28, 2010 the Authority issued \$761,400 in LIBOR floating rate notes to pay down \$819,150 of failed auction rate bonds from the 11th General. The notes were issued in one series at three month LIBOR plus 0.95% with an expected weighted average life of 6.89 years based on a two percent CPR and a final maturity of November 26, 2032. The trust, which had a starting parity of 106.34%, permits parity releases above 110% parity. The bonds were purchased from the 11th General at a purchase price of 92% of the principal amount, with respect to the senior purchased bonds, and 87% of the principal amount with respect to the subordinate purchased bonds, plus 100% of accrued and unpaid interest. The purchase of the bonds at a discount followed by the extinguishment of the bonds creates income and overcollateralization in the 11th General Resolution. This transaction also included a third party contribution of \$750. The excess cash and loan overcollateralization was released by 11th General to the Authority operating fund and 2010-1 Trust, respectively.

2010-2 LIBOR Floating Rate Notes — On May 26, 2010 the Authority issued \$822,500 in LIBOR floating rate notes to pay down the \$49,820 in fixed rate bonds from the 6th General, \$33,900 in VRDNs from the 8th General and \$704,000 in failed auction rate bonds from the 11th General. The \$822,500 million in bond proceeds were also utilized to purchase loans from the Authority's operating fund. The notes were issued in one series at three month LIBOR plus 0.85% with an expected weighted average life of 5.71 years based on a two percent CPR and a final maturity of August 27, 2029. The full turbo trust had a starting parity of 105.18%. The 6th and 8th General Resolutions were paid-in-full, however less than half of the remaining bonds under the 11th General Resolution were extinguished early. The bonds were extinguished early from the 11th General at a purchase price of 93.5% of principal, plus 100% of accrued and unpaid interest. As with the 2010-1 Trust, a significant amount of the income created by purchasing the bonds at a discount and extinguishing them early in the 11th General was released to the Authority's operating fund and as in the 2010-1 Trust the income had to first be recognized by the 11th General in order for it to be released to the Authority's operating fund and the 2010-2 Trust.

The financing transactions discussed in the three proceeding paragraphs resulted in a gain, net of unamortized cost of issuance, for the Authority of \$139,461.

9. CONTRACTS, COMMITMENTS, AND CONTINGENCIES

The Authority has three contracts to utilize electronic data processing systems. The contracts provide for monthly charges based on the number of student loan accounts serviced and the amount of computer equipment supplied.

Charges incurred under the contracts for the years ended June 30, 2010 and 2009, are as follows:

	2010	2009
Charges based on loan accounts	\$ 7,138	\$ 7,132
Hardware rentals	<u>37</u>	<u>37</u>
Total	<u>\$ 7,175</u>	<u>\$ 7,169</u>

To the extent permitted under applicable law, the Authority has authorized an expenditure of a maximum of \$550 in five equal annual installments beginning July 1, 2006, to support the University of Missouri — St. Louis GEAR UP (Gaining Early Awareness and Readiness for Undergraduate Programs) Partnership (the "Partnership"), which provides need-based scholarships and grants to students seeking higher education. Actual expenditures may be less in the event funding for these grants

and scholarships is obtained by members of the Partnership. The Authority's commitment expired on July 1, 2010 with no installments having been paid by the Authority.

The Authority is involved, from time to time, in various claims and lawsuits incidental to the ordinary course of its business. While the ultimate outcome of litigation cannot be predicted with certainty, management, based on its understanding of the facts, does not believe the ultimate resolution of these matters will have a material adverse effect on the Authority's financial position or results of operations.

10. EMPLOYEE BENEFITS

The Authority maintains a single employer defined contribution plan, the Higher Education Loan Authority of the State of Missouri 401(k) Plan (the "401(k) Plan"), with investment management performed by Goldman Sachs and recordkeeping provided by Edward Jones for all employees who are at least 21 years of age, and who work in excess of 1,000 hours per plan year, and who have been employed at least one year by the Authority. Employees may elect to defer 1% to 50% of their total compensation into the 401(k) Plan, not to exceed the limits defined in the 401(k) Plan. Sixteen investment fund options are available for choice by the employee. The Authority contributes an amount equal to 100% of the first 8% contributed by the employee. Employer matching funds are invested in the same fund choices made by the employee and are subject to a five-year vesting schedule. Some employer matching funds are offset by accumulated forfeiture credits. The Authority may make a non-matching contribution to the 401(k) Plan. The amount of this contribution, if any, will be determined by the Authority when granted. To be eligible for the contribution, an employee must be credited with at least 1,000 hours of service and be employed on the last day of the 401(k) Plan year. During 2010 and 2009, the Authority contributed \$510 and \$501 and employees contributed \$583 and \$553 to the 401(k) Plan.

The Authority offers a noncontributory defined benefit pension plan, the Higher Education Loan Authority of the State of Missouri Pension Plan (the "Pension Plan"). The Authority previously offered a defined benefit Excess Benefit Plan, to supplement the benefits provided under the defined contribution plan. The Excess Benefit Plan was terminated in December 2008. The Pension Plan is administered by Wells Fargo Institutional Retirement and Trust Advisors. Employees vest in the Pension Plan after five years of service. The Excess Benefit Plan, which was administered by Wachovia Securities, was a closed plan with a limited number of participants remaining. All obligations of the Excess Benefit Plan were settled and the remaining over funding was returned to the Authority resulting in a gain of \$1,543 after all expenditures (See Note 15). The Authority then contributed that balance from the Excess Benefit Plan to the Pension Plan. A report of the Pension Plan may be obtained by writing to the Authority's Pension Plan Administrator, 633 Spirit Drive, Chesterfield, MO 63005-1243 or by calling (636) 532-0600 with your request for a copy of the report of the Pension Plan. The Authority has elected to recognize prior service costs over a period which represents the estimated remaining service lives of the employees at the Pension Plan and Excess Benefit Plan origination dates.

Substantially all employees of the Authority are covered by the Pension Plan. Pension benefits are based upon the employee's length of service and average compensation.

Pension Plan assets are invested primarily in debt and equity securities at the discretion of the trustee. Those securities are valued at market value. The investment objective of the Plan is to ensure that assets will be available to meet the Plan's benefit obligations. The expected return on the Plan's assets is based on the historical and anticipated returns for each asset category. At June 30, 2010, the allocation was 97:3 investments in common collective trusts to cash. While at June 30, 2009, the allocation was 53:44:3 debt securities to equity securities to cash.

During the current year, the Authority contributed the actuarially determined minimum required funding. The annual required contribution for the years ended June 30, 2010, 2009, and 2008, was determined as part of the July 1, 2009, 2008, and 2007, respectively, actuarial valuations. The Authority's policy is to contribute annually not less than the actuarially determined minimum required contribution determined by using the Aggregate Actuarial Cost Method. Because this method is used, the amortization is a level percentage of payroll over the average remaining service life of active members. Separate determination and amortization of the unfunded actuarial liability are not part of such method and are not required when that method is used. There are no annual maximum contribution rates.

The following table establishes a display of the funding status measured as the ratio of Plan assets to actuarial accrued liability. This actuarial accrued liability is determined using the entry age actuarial cost method, as required for plans that use the Aggregate Cost Method to determine the recommended contribution.

Actuarial Valuation Date	Actuarial Value of Assets Available for Benefits	Actuarial Accrued Liability (AAL)	Funded Ratio	Unfunded AAL (UAAL)	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
Pension Plan 7/1/2009	\$18,562	\$20,675	89.8 %	\$ 2,113	\$10,708	19.7 %

The following tables detail the components of annual pension cost. The amounts recognized in the Authority's financial statements and major assumptions used to determine those amounts as of June 30, 2010, 2009, and 2008, are as follows:

	2010	2009	2008	
	Pension Plan	Pension Plan	Pension Plan	Excess Benefit Plan
Net pension obligation (NPO):				
NPO — beginning of year	\$ (5,570)	\$ (3,412)	\$ (3,581)	\$ (31)
Annual pension cost	2,280	1,878	2,207	6
Contributions for year	<u>(2,016)</u>	<u>(4,036)</u>	<u>(2,038)</u>	<u>-</u>
NPO — end of year	<u>\$ (5,306)</u>	<u>\$ (5,570)</u>	<u>\$ (3,412)</u>	<u>\$ (25)</u>
The negative NPO represents a pension asset.				
Components of annual pension cost:				
Annual required contribution (ARC)	\$ 2,016	\$ 1,717	\$ 2,038	\$ -
Interest on NPO	(389)	(239)	(251)	(2)
Adjustment to ARC	<u>653</u>	<u>400</u>	<u>420</u>	<u>8</u>
Annual Pension Cost (APC)	<u>\$ 2,280</u>	<u>\$ 1,878</u>	<u>\$ 2,207</u>	<u>\$ 6</u>

Percentage of ARC contributed	<u>100 %</u>	<u>235 %</u>	<u>100 %</u>	<u>100 %</u>
Major assumptions:				
Investment return	7 %	7 %	7 %	7 %
Inflation rate	4	4	4	4
Discount rate used for amortization of NPO	3	3	3	3
Salary scale	5	5	5	5
Amortization period (open) (years)	10.0	10.0	10.0	5.0
Cost method	Aggregate	Aggregate	Aggregate	Level Dollar
Mortality table	1994 Group Annuity Mortality table			

11. STUDENT LOAN PURCHASE COMMITMENTS

In addition to the student loans already purchased, the Authority has contractual commitments to purchase \$64,925 in FFELP loans from one of its lender partners under certain agreements. In addition, as of June 30, 2010, the Authority has contractual commitments to purchase \$26,979 in supplemental (alternative) loans from four lender partners. As it relates to \$20,379 of that commitment (3 of the 4 lender partners), if the Authority is unable to buy these loans the Authority's liability is limited to \$725. The Authority also has agreements with lending institutions that require the lender to use its best efforts to make and sell student loans to the Authority up to a contractually agreed-upon amount; however, the Authority has the right to refuse the purchase. The average length of the purchase commitments is three years. Management plans to fulfill the commitments using funds held by the Trustee, funds generated through the normal financing operations of the Authority and through the use of the Federal ECASLA programs. At June 30, 2010 and 2009, the Authority was servicing \$1,378,409 and \$2,454,893, respectively, in student loans for these and other lending institutions.

12. ARBITRAGE REBATE PAYABLE

In accordance with Section 148 and the regulations thereunder of the Internal Revenue Code of 1986, as amended, the Authority is required to pay to the United States Treasury certain amounts related to the Authority's tax-exempt bond issues. The amount required to be paid represents the excess of amounts earned over the interest cost of the tax-exempt borrowings. Non-purpose rebate payments are due every fifth year and when the bonds are retired. Purpose rebate payments are due every tenth year and every fifth year thereafter during the life of each bond issue and when the bonds are retired. The rebate calculation utilizes various assumptions and allows for the selection of alternative calculation options under the Code. Management estimates at June 30, 2010 and 2009, the liability to be \$4,725 and \$14,195, respectively, which has been provided for in the financial statements, however, the ultimate liability, if any, is dependent on investment yields and bond rates in the future.

The following table displays the aggregate changes in the arbitrage rebate payable for fiscal years ended June 30:

	2010	2009
Beginning balance	\$ 14,195	\$ 16,637
Reduction of arbitrage liability	(670)	(297)
Student loan forgiveness	<u>(8,800)</u>	<u>(2,145)</u>
Ending balance	<u>\$ 4,725</u>	<u>\$ 14,195</u>

The Authority annually employs an independent third party to prepare its arbitrage rebate calculation.

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of ASC 825 *Financial Instruments*. The estimated fair value amounts have been determined by the Authority using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Authority could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The estimated fair values of the Authority's financial instruments are as follows:

	June 30, 2010		June 30, 2009	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Assets:				
Cash and cash equivalents	\$ 242,721	\$ 242,721	\$ 145,363	\$ 145,363
Student loans receivable	4,229,752	4,229,752	4,415,658	4,382,174
Liabilities:				
Conduit payable	\$ 282,049	282,049	180,000	180,000
Bonds payable	3,498,972	3,498,972	3,879,200	3,877,584
ECASLA payable	468,817	468,817	285,600	285,600
Off-balance sheet instruments — standby letters of credit	\$ -	\$ 5,436	\$ -	\$ 6,661

Cash and Cash Equivalents — For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value based on the short-term nature of the security.

Student Loans Receivable — Loans are categorized by repayment type (in-school, grace, repayment, and delinquent). The fair value is estimated using the Authority's current pricing policies and the present value of the future cash flow stream. Due to the variable rates of the Authority's student loan receivable portfolio, the carrying value of the portfolio approximates the estimated fair value at June 30, 2010. Estimated fair value approximates the amount for which similar loans could currently be purchased on the open market.

ECASLA Payable — For the ECASLA payable, the carrying value is a reasonable estimate of fair value as the maturity of the instrument is less than one year.

Conduit Payable — For the conduit payable, the carrying value is a reasonable estimate of fair value as the line of credit has a variable rate.

Bonds Payable — For fixed rate bonds, fair value was calculated from quoted market prices of the bonds. For variable rate bonds, the carrying amount is a reasonable estimate of fair value. There were no fixed rate bonds outstanding at June 30, 2010.

Standby Letters of Credit — The fair value is based on fees currently charged for similar agreements at the reporting date.

14. SEGMENT INFORMATION

A segment is an identifiable activity reported as a stand-alone entity for which one or more revenue bonds or other financing is outstanding. A segment has a specific identifiable revenue stream pledged in support of the related debt and has related expenses, gains and losses, assets, and liabilities that are required by an external party to be accounted for separately. The Authority has 12 segments that meet the reporting requirements of GASB Statement No. 34.

The outstanding debt of the Authority consists of Student Loan Revenue Bonds, a line of credit, the Federal ECASLA Loan Participation program and commercial paper conduit. The Student Loan Revenue Bonds are issued in accordance with four separate General Student Loan Program Bond Resolutions adopted by the Board of Directors in various years from 1988 through 2007, as well as in accordance with a two Trust Indenture (the "Indenture") adopted by the Board of Directors in 2005 and 2008. The Resolutions provide that the bonds are payable from the eligible loans pledged under the Resolutions, amounts deposited in the accounts pledged under the Resolutions and all other revenues and recoveries of principal from the loans purchased with the bond proceeds.

Administrative transactions not directly associated with the purchase of and revenue streams related to student loans are recorded in the Operating Fund.

Summary financial information for the Student Loan Revenue Bonds as of June 30, 2010 and 2009, are as follows:

	2010													
	Bond Funds													
Condensed Statements of Net Assets	6th General Resolution Trust Estate	8th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture	Operating Fund	Total
Assets:														
Current assets	\$ -	\$ -	\$ 195,660	\$ 53,764	\$ -	\$ 32,271	\$ 40,232	\$475,089	\$ -	\$ 20,834	\$112,588	\$114,801	\$100,869	\$ 1,146,108
Long-term assets	-	-	1,056,715	261,666	-	252,854	258,796	22	-	172,906	686,192	757,441	32,097	3,478,689
Total assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,252,375</u>	<u>\$315,430</u>	<u>\$ -</u>	<u>\$285,125</u>	<u>\$299,028</u>	<u>\$475,111</u>	<u>\$ -</u>	<u>\$193,740</u>	<u>\$798,780</u>	<u>\$872,242</u>	<u>\$132,966</u>	<u>\$4,624,797</u>
Liabilities:														
Current liabilities	\$ -	\$ -	\$ 17,743	\$ 1,640	\$ -	\$ 4,235	\$284,623	\$479,963	\$ -	\$ 11,913	\$ 70,344	\$ 76,337	\$ 3,347	\$ 950,145
Long-term liabilities	-	-	1,204,900	296,798	-	262,502	-	-	-	168,040	677,394	749,908	-	3,359,542
Interfund payable (receivable)	-	-	(9,987)	(1,910)	-	(740)	(189)	(6,484)	-	(146)	(2,228)	(2,640)	24,324	-
Total liabilities	<u>-</u>	<u>-</u>	<u>1,212,656</u>	<u>296,528</u>	<u>-</u>	<u>265,997</u>	<u>284,434</u>	<u>473,479</u>	<u>-</u>	<u>179,807</u>	<u>745,510</u>	<u>823,605</u>	<u>27,671</u>	<u>4,309,687</u>
Net assets:														
Invested in capital assets	-	-	-	-	-	-	-	-	-	-	-	-	14,045	14,045
Restricted	-	-	35,429	3,902	-	15,817	14,594	1,632	-	13,933	53,270	48,637	30,000	217,214
Unrestricted	<u>-</u>	<u>-</u>	<u>4,290</u>	<u>15,000</u>	<u>-</u>	<u>3,311</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>61,250</u>	<u>83,851</u>
Total net assets	<u>-</u>	<u>-</u>	<u>39,719</u>	<u>18,902</u>	<u>-</u>	<u>19,128</u>	<u>14,594</u>	<u>1,632</u>	<u>-</u>	<u>13,933</u>	<u>53,270</u>	<u>48,637</u>	<u>105,295</u>	<u>315,110</u>
Total liabilities and net assets	<u>\$ -</u>	<u>\$ -</u>	<u>\$1,252,375</u>	<u>\$315,430</u>	<u>\$ -</u>	<u>\$285,125</u>	<u>\$299,028</u>	<u>\$475,111</u>	<u>\$ -</u>	<u>\$193,740</u>	<u>\$798,780</u>	<u>\$872,242</u>	<u>\$132,966</u>	<u>\$4,624,797</u>

Condensed Statements of Net Assets	2009										
	Bond Funds									Operating Fund	Total
	6th General Resolution Trust Estate	8th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit		
Assets:											
Current assets	\$ 3,042	\$ 2,659	\$ 192,998	\$ 37,013	\$ 18,245	\$ 12,861	\$ 13,369	\$289,072	\$3,260	\$178,400	\$ 750,919
Long-term assets	<u>53,401</u>	<u>38,347</u>	<u>2,770,214</u>	<u>312,370</u>	<u>321,840</u>	<u>272,380</u>	<u>198,835</u>	<u>-</u>	<u>400</u>	<u>18,357</u>	<u>3,986,144</u>
Total assets	<u>\$56,443</u>	<u>\$41,006</u>	<u>\$2,963,212</u>	<u>\$349,383</u>	<u>\$340,085</u>	<u>\$285,241</u>	<u>\$212,204</u>	<u>\$289,072</u>	<u>\$3,660</u>	<u>\$196,757</u>	<u>\$4,737,063</u>
Liabilities:											
Current liabilities	\$ 544	\$ 208	\$ 93,857	\$ 1,525	\$ 55,866	\$ 4,449	\$185,627	\$292,881	\$ 530	\$147,649	\$ 783,136
Long-term liabilities	50,000	41,359	2,792,709	341,189	297,226	263,037	-	-	-	-	3,785,520
Interfund payable (receivable)	<u>(367)</u>	<u>(627)</u>	<u>(5,842)</u>	<u>(1,953)</u>	<u>(227)</u>	<u>(507)</u>	<u>(359)</u>	<u>(3,785)</u>	<u>(395)</u>	<u>14,062</u>	<u>-</u>
Total liabilities	<u>50,177</u>	<u>40,940</u>	<u>2,880,724</u>	<u>340,761</u>	<u>352,865</u>	<u>266,979</u>	<u>185,268</u>	<u>289,096</u>	<u>135</u>	<u>161,711</u>	<u>4,568,656</u>
Net assets:											
Invested in capital assets	-	-	-	-	-	-	-	-	-	14,182	14,182
Restricted	5,018	66	82,488	5,226	(12,780)	15,821	26,936	(24)	3,525	-	126,276
Unrestricted	<u>1,248</u>	<u>-</u>	<u>-</u>	<u>3,396</u>	<u>-</u>	<u>2,441</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>20,864</u>	<u>27,949</u>
Total net assets	<u>6,266</u>	<u>66</u>	<u>82,488</u>	<u>8,622</u>	<u>(12,780)</u>	<u>18,262</u>	<u>26,936</u>	<u>(24)</u>	<u>3,525</u>	<u>35,046</u>	<u>168,407</u>
Total liabilities and net assets	<u>\$56,443</u>	<u>\$41,006</u>	<u>\$2,963,212</u>	<u>\$349,383</u>	<u>\$340,085</u>	<u>\$285,241</u>	<u>\$212,204</u>	<u>\$289,072</u>	<u>\$3,660</u>	<u>\$196,757</u>	<u>\$4,737,063</u>

Condensed Statements of Revenues, Expenses and Changes in Net Assets	2010													
	Bond Funds												Operating Fund	Total
	6th General Resolution Trust Estate	8th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture		
Operating revenues	\$ (56)	\$ 435	\$171,061	\$19,721	\$ 25,348	\$ 7,096	\$ 5,740	\$4,169	\$ 66	\$ 3,783	\$ 9,483	\$ 2,110	\$ 15,527	\$264,483
Operating expenses	<u>2,362</u>	<u>(466)</u>	<u>58,288</u>	<u>9,416</u>	<u>6,870</u>	<u>6,234</u>	<u>3,882</u>	<u>2,091</u>	<u>725</u>	<u>3,556</u>	<u>8,740</u>	<u>2,451</u>	<u>13,631</u>	<u>117,780</u>
Operating (loss) income	(2,418)	901	112,773	10,305	18,478	862	1,858	2,078	(659)	227	743	(341)	1,896	146,703
Interfund transfers	<u>(3,848)</u>	<u>(967)</u>	<u>(155,544)</u>	<u>(25)</u>	<u>(5,698)</u>	<u>4</u>	<u>(14,200)</u>	<u>(422)</u>	<u>(2,865)</u>	<u>13,706</u>	<u>52,527</u>	<u>48,978</u>	<u>68,354</u>	<u>-</u>
Increase (decrease) in net assets	(6,266)	(66)	(42,771)	10,280	12,780	866	(12,342)	1,656	(3,524)	13,933	53,270	48,637	70,250	146,703
Net assets — beginning of year	<u>6,266</u>	<u>66</u>	<u>82,490</u>	<u>8,622</u>	<u>(12,780)</u>	<u>18,262</u>	<u>26,936</u>	<u>(24)</u>	<u>3,524</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>35,045</u>	<u>168,407</u>
Net assets — end of year	\$ -	\$ -	\$ 39,719	\$18,902	\$ -	\$19,128	\$ 14,594	\$1,632	\$ -	\$13,933	\$53,270	\$48,637	\$105,295	\$315,110

2009														
Condensed Statements of Revenues, Expenses and Changes in Net Assets	Bond Funds													
	6th General Resolution Trust Estate	8th General Resolution Trust Estate	9th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit	Operating Fund	Total		
Operating revenues	\$ 1,944	\$1,445	\$ 420	\$140,531	\$16,831	\$ 12,513	\$ 6,684	\$ 7,883	\$1,270	\$ 4,781	\$ (186)	\$194,116		
Operating expenses	<u>3,179</u>	<u>1,794</u>	<u>1,376</u>	<u>131,966</u>	<u>15,332</u>	<u>25,490</u>	<u>5,638</u>	<u>6,951</u>	<u>1,294</u>	<u>3,767</u>	<u>(7,656)</u>	<u>189,131</u>		
Operating (loss) income	(1,235)	(349)	(956)	8,565	1,499	(12,977)	1,046	932	(24)	1,014	7,470	4,985		
Special items	-	(7)	(359)	50,459	(1)	(181)	-	-	-	-	1,443	51,354		
Interfund transfers	<u>-</u>	<u>-</u>	<u>(513)</u>	<u>370</u>	<u>-</u>	<u>-</u>	<u>17,216</u>	<u>18,680</u>	<u>-</u>	<u>(5,755)</u>	<u>(29,998)</u>	<u>-</u>		
Increase (decrease) in net assets	(1,235)	(356)	(1,828)	59,394	1,498	(13,158)	18,262	19,612	(24)	(4,741)	(21,085)	56,339		
Net assets — beginning of year	<u>7,501</u>	<u>422</u>	<u>1,828</u>	<u>23,094</u>	<u>7,124</u>	<u>378</u>	<u>-</u>	<u>7,324</u>	<u>-</u>	<u>8,266</u>	<u>56,131</u>	<u>112,068</u>		
Net assets — end of year	<u>\$ 6,266</u>	<u>\$ 66</u>	<u>\$ -</u>	<u>\$ 82,488</u>	<u>\$ 8,622</u>	<u>\$(12,780)</u>	<u>\$18,262</u>	<u>\$26,936</u>	<u>\$ (24)</u>	<u>\$ 3,525</u>	<u>\$ 35,046</u>	<u>\$168,407</u>		
2010														
Condensed Statements of Cash Flow	Bond Funds													
	6th General Resolution Trust Estate	8th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit	2009-1 Trust Indenture	2010-1 Trust Indenture	2010-2 Trust Indenture	Operating Fund	Total
Net cash flows from operating activities	\$ 51,861	\$ 37,918	\$ 1,545,515	\$ 32,793	\$ 324,100	\$ 3,148	\$ (96,935)	\$(181,798)	\$(3,201)	\$(167,113)	\$(704,230)	\$(792,774)	\$65,080	\$114,364
Net cash flows from non-capital financing activities	(52,399)	(39,204)	(1,554,890)	(41,564)	(331,741)	(1,483)	100,587	181,171		174,677	732,367	816,529	(117)	(16,067)
Net cash flow from capital activities	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(939)</u>	<u>(939)</u>
Net increase (decrease) in cash and cash equivalents	(538)	(1,286)	(9,375)	(8,771)	(7,641)	1,665	3,652	(627)	(3,201)	7,564	28,137	23,755	64,024	97,358
Cash and cash equivalents — beginning of year	<u>538</u>	<u>1,286</u>	<u>75,852</u>	<u>16,675</u>	<u>7,641</u>	<u>3,358</u>	<u>5,898</u>	<u>3,954</u>	<u>3,201</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>26,960</u>	<u>145,363</u>
Cash and cash equivalents — end of year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 66,477</u>	<u>\$ 7,904</u>	<u>\$ -</u>	<u>\$ 5,023</u>	<u>\$ 9,550</u>	<u>\$ 3,327</u>	<u>\$ -</u>	<u>\$ 7,564</u>	<u>\$ 28,137</u>	<u>\$ 23,755</u>	<u>\$ 90,984</u>	<u>\$ 242,721</u>

Condensed Statements of Cash Flow	2009											
	Bond Funds											
	6th General Resolution Trust Estate	8th General Resolution Trust Estate	9th General Resolution Trust Estate	11th General Resolution Trust Estate	12th General Resolution Trust Estate	2005 Trust Indenture	2008 Trust Indenture	Commercial Paper Conduit	ECASLA	Line of Credit	Operating Fund	Total
Net cash flows from operating activities	\$ 2,343	\$ 1,847	\$ 35,202	\$ 41,276	\$ 37,241	\$ 51,280	\$(256,541)	\$(26,911)	\$(280,576)	\$ 304,378	\$ (3,649)	\$ (94,110)
Net cash flows from non-capital financing activities	(2,050)	(2,457)	(38,236)	(31,258)	(24,583)	(57,501)	259,899	30,917	284,530	(302,822)	(100)	116,339
Net cash flow from capital activities	-	-	-	-	-	-	-	-	-	-	(890)	(890)
Net increase (decrease) in cash and cash equivalents	293	(610)	(3,034)	10,018	12,658	(6,221)	3,358	4,006	3,954	1,556	(4,639)	21,339
Cash and cash equivalents — beginning of year	245	1,896	3,034	65,834	4,017	13,862	-	1,892	-	1,645	31,599	124,024
Cash and cash equivalents — end of year	<u>\$ 538</u>	<u>\$ 1,286</u>	<u>\$ -</u>	<u>\$ 75,852</u>	<u>\$ 16,675</u>	<u>\$ 7,641</u>	<u>\$ 3,358</u>	<u>\$ 5,898</u>	<u>\$ 3,954</u>	<u>\$ 3,201</u>	<u>\$26,960</u>	<u>\$145,363</u>

15. SPECIAL ITEMS

There were no special items within the statement of revenues, expenses, and changes in net assets for the year ended June 30, 2010. The descriptions below relate to those changes classified as special items within the statement of revenues, expenses, and changes in net assets for the year ended June 30, 2009.

Lewis and Clark Distribution — On August 28, 2007, legislation establishing the Lewis and Clark Discovery Initiative (the “Initiative”) became law. The legislation, known as Senate Bill 389 (the “LCDI Legislation”) directs the Authority to distribute \$350,000 into a new fund in the State Treasury known as the Lewis and Clark Discovery Fund (the “Fund”) on the following schedule: \$230,000 no later than September 15, 2007; an additional \$5,000 by December 31, 2007; and further installments of \$5,000 each calendar quarter through September 30, 2013. During fiscal year 2010, the Authority and the Missouri Commissioner of the Office of Administration agreed to extend the date of final distributions to September 30, 2015. Investment earnings on the Fund are credited against subsequent payments made by the Authority. In addition, the LCDI Legislation provides that the Authority may delay payments if the Authority determines that any such distribution may materially adversely affect the service and benefits provided to Missouri students or residents in the ordinary course of the Authority’s business, the borrower benefit programs of the Authority or the economic viability of the Authority. However, the entire \$350,000 is to be paid by September 30, 2013, unless otherwise approved by the Authority and the Missouri Commissioner of the Office of Administration.

The Authority receives a significant benefit pursuant to the LCDI Legislation. The new law provides that following the initial September 15, 2007, distribution by the Authority, the Missouri Director of Economic Development shall allocate to and reserve for the Authority in 2007 and the next 14 years at least 30% of Missouri’s tax-exempt, private activity bond cap allocation. This allocation was \$150,750 for calendar year 2009. The amount of this allocation may be reduced for 2014 and later years by the percentage of the \$350,000 not paid by the Authority to the Fund by the end of the preceding year.

On September 14, 2007, the Authority remitted to the State Treasurer \$230,000 for the initial payment in accordance with an Authority Board Resolution and as required by the LCDI Legislation. Two subsequent quarterly payments totaling \$3,826 have been made which represents the difference between the required payment of \$5,000 and interest earned, bringing the Authority current through March 31, 2008. On June 26, 2008, the Board voted to delay making the June 30, 2008, quarterly payment and on September 12, 2008, the Board voted to make a partial quarterly payment on September 30, 2008 of \$100. For each subsequent quarterly payment for the years ended June 30, 2010 and 2009, the Board did not authorize payment. Accrued interest earned for the year ended June 30, 2010 and 2009 totaled \$ 907 and \$3,744, respectively.

The Board will continue analyzing and determining on a quarterly basis what, if any, distribution the Authority should make to the LCDI Fund. Regardless of what distribution the Board authorizes in any given quarter, the LCDI Fund will continue to receive quarterly distributions of interest earned on the LCDI Fund. While the quarterly interest income distributions are not paid directly by the Authority, it reduces the amount the Authority has to pay under the LCDI statute.

Excess Benefit Plan — Effective July 2001, the Authority adopted the Excess Benefit Plan. The Plan was intended to make up the benefits not available under the Qualified Pension Plan benefit formula solely because of the Internal Revenue Code Section 15 Restriction. The Excess Benefit Plan was a closed plan with a limited number of participants remaining.

In June 2008, the Board approved the termination of the Excess Benefit Plan. After all obligations were settled, the gain recognized from the Excess Benefit Plan termination was \$1,543. The over funding gain

from the Excess Benefit Plan was contributed to the Qualified Pension Plan in addition to the annual required contribution. The distribution in excess of the annual required contribution was capitalized within the prepaid asset within the Statement of Net Assets.

Gain on Cancellation of Debt — During the year ending June 30, 2009, a \$49,911 gain on cancellation of debt was recognized. Most of the gain was a result of two transactions in which the Authority sold student loans to financial institutions at par and purchased failed auction rate bonds at a discount from the financial institutions. The bonds were immediately cancelled upon purchase. The gain on cancellation of the bonds was \$47,811 after one-time expenses for the accelerated amortization of \$4,521 in unamortized loan purchase premiums proportional to the loans sold and the accelerated amortization of \$4,894 in unamortized costs of issuance associated with the bonds cancelled. In addition, during the year ending June 30, 2009 the Authority purchased bonds directly from bondholders at a discount in the open market and cancelled the bonds, resulting in a \$2,100 gain on cancellation of debt.

16. SUBSEQUENT EVENTS

Access Missouri Scholarship Funding — The Authority and the Missouri Commissioner of the Office of Administration recently agreed to extend, by two years to September 30, 2015, the date of final distributions by the Authority of the full \$350,000 described in the LCDI Legislation. In connection with this extension, the Authority agreed to provide the State with \$30,000 of its operating funds to be used for need-based scholarship funding for Missouri students for the 2010-2011 academic year. This amount will partially offset dramatic reductions in scholarship funding by the State of Missouri due to budget shortfalls. This amount became available due to a recent successful bond refinancing by the Authority. The first payment of \$9,000 was made to the State of Missouri on September 1, 2010, with subsequent payments of varying amounts planned on the first of the month for the next 7 months.

The Authority will continue analyzing and determining on a quarterly basis what, if any, distribution the Authority should make to the LCDI Fund. The Authority is unsure whether it will be able to make any significant future distributions required by the LCDI Legislation on a timely basis or at all. Any such distributions by the Authority could substantially decrease the amount of its capital and, accordingly, erode its funds for new programs and contingencies related to current operations.

2010-3 LIBOR Floating Rate Notes — On September 28, 2010 the Authority issued \$495,200 in LIBOR floating rate notes to purchase FFELP loans from its lender partners. The \$495,200 million in bond proceeds were also utilized to purchase loans from the Authority's operating fund. The notes were issued in one series at three month LIBOR plus 0.85% with an expected weighted average life of 5.94 years based on a two percent CPR and a final maturity of August 26, 2030. The full turbo trust had a starting parity of 105.89%.

12th General Resolution Trust Estate — On August 9, 2010, the Authority's 12th General transaction was placed on credit watch negative by Standard & Poor's. According to Standard & Poor's press release related to the matter, which also included actions on other Issuer's student loan trusts, the action was taken to reflect the high percentage of non-federally guaranteed private loans serving as collateral to the trust, the past and future performance expectations of those private loans, the level of credit enhancement present in the trust and the need for enhanced levels of data reporting related to the performance of the private loans. The Authority is cooperating with Standard & Poor's to provide additional information on the collateral. If the bonds are downgraded it could lead to higher interest rates being paid on the bonds, which will reduce the excess spread in the trust.

The principal of and interest on the 12th General bonds are insured by financial guaranty policies provided by Ambac Assurance Corporation ("Ambac"), which also provides a surety bond that funds the

reserve requirements for the bonds. On March 24, 2010, the Commissioner of Insurance of the State of Wisconsin petitioned the Wisconsin Circuit Court, filing a Verified Petition for Order of Rehabilitation in the matter of the Rehabilitation of Segregated Account of Ambac, which identified certain of Ambac's insurance policies to be placed into a segregated account for rehabilitation. Pursuant to the petition, the segregated account is to be treated as a separate insurer for purposes of insurance delinquency proceedings. While the 12th General policies were not initially on the list of insurance policies to be placed into the segregated account, each was identified as a policy to be considered for possible placement in the segregated account. On October 8, 2010, the Commissioner of Insurance of the State of Wisconsin submitted a supplement to the petition in order to allocate certain Ambac policies related to student loan obligations to the segregated account. The Authority received notice of this action on October 13, 2010, and learned that the 12th General policies were among those placed in the segregated account.

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HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

REQUIRED SUPPLEMENTARY INFORMATION SCHEDULE OF FUNDING PROGRESS AS OF AND FOR THE YEARS ENDED JUNE 30, 2010, 2009 AND 2008 (Dollars in thousands) (Unaudited)

Actuarial Valuation Date	Actuarial Value of Assets Available for Benefits	Actuarial Accrued Liability (AAL)	Funded Ratio	Unfunded AAL (UAAL)	Annual Covered Payroll	UAAL as a Percentage of Covered Payroll
Pension Plan 7/1/2009	\$18,562	\$20,675	89.8 %	\$ 2,113	\$10,708	19.7 %
Pension Plan 7/1/2008	18,939	19,224	98.5 %	285	10,195	2.8 %
Pension Plan 7/1/2007	18,148	18,585	97.6 %	437	12,159	3.6 %
Excess Benefit Plan 7/1/2007	4,656	2,481	187.7 %	-	220	-

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED UPON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Higher Education Loan Authority
of the State of Missouri:

We have audited the financial statements of the Higher Education Loan Authority of the State of Missouri (the "Authority") as of and for the year ended June 30, 2010, and have issued our report thereon dated October 1, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting, described in the schedule of findings and questioned costs that we consider to be a significant deficiency in internal control over financial reporting as 2010-1. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the

determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Authority's response to the finding identified in our audit is described in the accompanying schedule of findings and questioned costs. We did not audit the Authority's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, Board of Directors, others within the entity and the Department of Education and is not intended to be and should not be used by anyone other than these specified parties.

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October 1, 2010

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON THE FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH THE PROGRAM- SPECIFIC AUDIT OPTION UNDER OMB CIRCULAR A-133

To the Higher Education Loan Authority
of the State of Missouri:

Compliance

We have audited the Higher Education Loan Authority of the State of Missouri's (the "Authority's") compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Authority's major federal programs for the year ended June 30, 2010. The Authority's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2010.

Internal Control Over Compliance

Management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Authority's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the

purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, Board of Directors, others within the entity and the Department of Education and is not intended to be and should not be used by anyone other than these specified parties.

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October 1, 2010

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

SUPPLEMENTARY SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2010

(Dollars in thousands)

Federal Grantor	Federal CFDA Number	Federal Expenditures Received
U.S. DEPARTMENT OF EDUCATION — Federal Family Education Loan Program (FFELP) — interest on student loans	84.032	\$ 31,272
U.S. DEPARTMENT OF EDUCATION — Ensuring Continued Access to Student Loans Act of 2008 (ECASLA) — Income	84.032	<u>19,578</u>
TOTAL	84.032	<u>\$ 50,850</u>
		Outstanding Balance at June 30, 2010
TOTAL GUARANTEED LOANS OF THE AUTHORITY AT JUNE 30, 2010 — Guaranteed student loans:		
FFELP Program	84.032	\$4,013,651
Health Education Assistance Loan Programs (HEAL)	93.108	<u>473</u>
TOTAL		<u>\$4,014,124</u>

HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

NOTES TO SUPPLEMENTARY SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS FOR THE YEAR ENDED JUNE 30, 2010

1. DESCRIPTION OF PROGRAMS

U.S. Department of Education — FFELP enables the Higher Education Loan Authority of the State of Missouri (the “Authority”) to receive interest on subsidized guaranteed student loans during the period a student is attending school or during certain other allowable deferment periods.

The ECASLA programs enable the Authority to access affordable funding to purchase and originate loans and continue to carry out its purpose.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the federal awards program of the Authority conform to accounting principles generally accepted in the United States of America. The following is a summary of the Authority’s significant accounting policies for federal programs.

Basis of Accounting — The Authority maintains its schedule of expenditures of federal awards on an accrual basis of accounting. Under this method, revenues are recognized when earned and expenses are recognized when incurred.

Federal Revenues — The FFELP interest and the ECASLA income is used primarily for the purchase of student loans and the administration of the Student Loan Programs.

3. CONTINUING COMPLIANCE REQUIREMENTS

Guaranteed student loans impose no continuing compliance requirements other than to repay the loans and are not considered federal awards expended.

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HIGHER EDUCATION LOAN AUTHORITY OF THE STATE OF MISSOURI

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2010

Part I — Summary of Auditors' Results

Financial Statements:

Type of auditors' report issued — unqualified

Internal control over financial reporting:

Material weakness(es) identified? ☐ yes ☒ no

Significant deficiencies identified not considered to be material weakness(es)? ☒ yes ☐ N/A

Noncompliance material to financial statements noted? ☐ yes ☒ no

Federal Awards:

Internal control over financial reporting:

Material weakness(es) identified? ☐ yes ☒ no

Significant deficiencies identified not considered to be material weakness(es)? ☐ yes ☒ N/A

Type of auditors' report issued on compliance for major programs — unqualified

Any audit findings disclosed that are required to be reported in accordance with Circular A-133 (section .510(a))? ☐ yes ☒ no

Identification of major programs:

CFDA Number(s)

Name of Federal Program or Cluster

84.032 & 93.108

Student Financial Aid Cluster

Dollar threshold used to distinguish between Type A and Type B programs — \$1,525,498

Auditee qualified as a low-risk auditee? ☒ yes ☐ no

Part II — Financial Statement Finding Section

2010-1

Condition — Elements of the financial statements, including but not limited to the statement of cash flows and related segment disclosures, were initially prepared by individuals at the Authority and significantly adjusted by the auditors. Auditor assistance in the preparation of the financial statements is consistent with historical practice.

Criteria or Specific Requirement — GASB Statement No. 34 stipulates that the Authority must present a Statement of Cash Flows utilizing both the direct and indirect method. Furthermore, for Segment Reporting purposes, the Statement of Cash Flows must be presented as well for each segment that meets the reporting requirements of GASB Statement No. 34. Additionally, in May 2006, the AICPA issued Statement of Auditing Standards No. 112, “Communicating Internal Control Related Matters Identified in an Audit” which was amended in September 2008. The auditing standards provide guidance on communicating matters related to an entity’s internal control over financial reporting identified in an audit of financial statements.

Effect — Multiple adjustments were required to the initial 2010 statement of cash flows and segment reporting disclosure provided by management of the Authority in order to ensure compliance with Generally Accepted Governmental Accounting Standards.

Cause — The Authority does not have a financial reporting department whose responsibility it is to understand and prepare financial statements and related disclosures. Additionally, the management review process was not performed in sufficient detail to detect material misstatements, or disclosure deficiencies, contained within the Statement of Cash Flows and segment reporting as initially presented to the auditors.

Questioned Costs — None.

Context — At June 30, 2010, prior to adjustments, cash used for student loan and interest purchases and originations within operating activities was reported as \$1,388,494. Subsequent to adjustments, management actually reported cash used for student loan and interest purchases and originations within operating activities as \$1,038,684.

Recommendation — Management should ensure the cash flow statement is prepared by individuals with adequate knowledge of accounting standards and should implement a formalized and detailed review process to ensure the accuracy of the cash flow statement and related disclosures.

Management’s Corrective Action Plan (Unaudited) — Management will work in the coming months to develop a more formalized and detailed preparation and review process for the cash flow statement and related segment footnote.

Part III — Federal Awards Findings and Questioned Cost Section

No matters are reportable.

**HIGHER EDUCATION LOAN AUTHORITY
OF THE STATE OF MISSOURI**

**STATUS OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010**

None.